ECONOMIC DESTINY

BY

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PREFACE

In the restless twenty years between the two great wars which this generation has seen, grave and deep-seated defects were disclosed in the economic life of the world, defects which inevitably pointed the way to change. Change there must be, and proposals for change abound. By the character of the changes to be made the economic future of humanity will be determined.

To weigh the fateful tendencies at work, it is necessary to view the problem as a whole. This book was planned before the war; its purpose is to trace our economic troubles to their sources, and to subject the various proposals for change to critical examination. The war has not fundamentally altered the position, but it has cleared the ground for change, and made the need for critical examination more urgent.

For any of the various proposals for change which command support it would be easy to make a case. But my purpose is not to follow diagnosis with prescription; it is rather to disclose the underlying forces by which whatever changes are instituted will ultimately be shaped.

Among the causes of economic disorder a leading place has to be assigned to the international anarchy and its unceasing threat of war in the terrible form nowadays of total war. That is not primarily an economic phenomenon, but it has profound and far-reaching economic reactions: in economic resources as a source of power, and therefore an object of national ambition; in the demands made on productive power by war and preparation for war; finally but less obviously in the recklessness resulting from economic distress, which may plunge the world into war.

On the other hand there are internal strains in the economic system. The most pervasive is that resulting from unstable money, on the intimate relation of which to depression, unemployment and the breakdown of international trade we shall have much to say.

Less conspicuous, but not less fundamental, is the challenge to profit-making. Profit-making is essential to the existing economic organisation of society, but gives rise to crying anomalies. Marx's attack on it was entangled in the crudities of the economic theory of his own day, but its influence has persisted, and the efforts of orthodox economists to explain profit away, as no more than a reasonable compensation for risk-taking and for exceptional ability, supplemented by occasional illicit monopoly gains, have not availed to displace it.

Herein is the driving force behind communism, or, to use a less

provocative word, collectivism. One of the great questions which only destiny will answer is the choice to be made between our existing economic institutions and collectivism. Collectivism has been chosen in Russia ; in the rest of the world the choice has yet to be posed.

The choice is not correctly stated to be between collectivism on the one hand and let-do on the other. Even with a foundation of private enterprise, deriving profits from competition in markets, there is scope for a wide variety of Government activities. Totalitarian regimentation itself, as practised in Germany, retains a background of private enterprise. The power and authority conferred on the central executive by modern means of communication and organisation impose a corresponding responsibility. A Government cannot afford to tolerate the continuance of an acknowledged evil, if there is a practicable remedy within the limits of its sovereign power.

If competitivism is to be retained as the governing principle of economic life, it must be in association with the exercise of Government interference wherever positively desirable. It may be that competitivism under such conditions will ultimately be submerged altogether ; it may be that it will break down, either from the burden of armaments or from internal strain ; or it may be that it will take on a new lease of life.

A criticism of economic measures and institutions cannot be divorced from ethical standards. The idea of a positive economic science, abstracted from the fundamentals of good and bad, is untenable. Even when the economist has to advise the means of working for a non-ethical or unethical purpose, he cannot divest his choice of means of ethical implications. And when he is called upon to criticise a policy, the ends themselves must be subjected to his judgment.

There is need of faith, not subordinated to any particular cult or tied to any theological or philosophical system, but a living conviction, faith in the rightness of our ends, and in the competence of wisdom to discern the means.

This book represents my personal views, and is not to be associated in any way with my official position at the Treasury.

February 1944. R. G. Hawtrey.

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ECONOMIC DESTINY

CHAPTER I

INTRODUCTORY

1. Has there ever been a time when the future of human society seemed so uncertain as now? While on all sides doubt has been thrown on guiding principles of the past, vast forces, human and material, have been placed by modern technical progress in the hands of leaders who are more in need of guiding principles than ever before.

The frightful clash of a great war is not the cause of this paralysing perplexity, it is rather a consequence, a symptom, a menacing portent. In the years that intervened between the signature of peace in 1919 and the outbreak of war in 1939, as the disorders of the economic system became more and more glaring, the helplessness of those responsible for remedying them became more and more obvious. In the state of bewilderment in which peoples and leaders were alike involved, when reasoned plans seemed all to end in frustration, impatient human nature turned to desperate courses. Desperate courses do not help. But an outbreak of hate and destruction does force humanity more urgently to seek a way out of its troubles.

It is only too easy to declaim with all the resources of invective and diatribe, rhetoric and irony, on the lamentable breakdown of economic institutions, the agonies of unemployment, the waste of productive power, the destruction of unsaleable produce, the frantic urge to sell rather than to buy, to export rather than to import, above all, the plunge into cruel senseless war. How often has the written or spoken word rung the changes on this dismal tale of distresses!

Through all runs the insistent accusation that the fault lies with human indifference, supineness and short-sightedness. The implication is that, if only people could be brought to see how disastrous is the situation to which they have been brought, they would stir themselves to set it right.

Or it is contended that the root of the evil is rather in a failure of ideals, and that a moral or religious conversion is the essential step.

Das Kapital, *The Song of the Shirt* and *Uncle Tom's Cabin* appealed to the emotions and made their contributions to economic progress. But it is not enough to make people see the evil and to stir up the will to remedy it. Rhetoric is not necessary to show that something is gravely amiss. Mankind is neither so irrational nor so wicked as not to take the way out if the way be clear. The need is for clear

thinking, clear systematic and objective thinking, in which rhetorical appeals are out of place.

What, it may be asked, is the function of the economic science we have if not clear systematic and objective thinking? With all respect to the many active and brilliant minds enlisted in the following of economic science, I see three vital matters on which it has failed to base guidance on conviction.

In the first place it offers no accepted theory of *profit*;
Secondly, it has never clearly determined the place of *money* in the economic system;
And, thirdly, it has not taken sufficient account of *power* as a continuing and dominating object of economic policy.

It is, I believe, in consequence of the want of consistent doctrine in these three directions that statesmanship has been found so disastrously at a loss.

Proposals for economic reconstruction are to be encountered on all sides. Each plans a future destination for the economic institutions of the world. But for what is our economic life destined? Its destination is proposed, but its destiny is disposed. Destiny is conditioned by multifarious facts and tendencies of human nature, of history and of the physical world.

To prophesy destiny would be vanity and striving after wind. But systematic thinking can be applied to the visible economic tendencies of the time. Every defect felt in the economic system is itself an impulse towards change. Blind yielding to the impulse may make things worse instead of better. My purpose in the present work is to examine the different ways in which these impulses towards change may seek satisfaction, and to follow out their implications.

While such a study is primarily economic, it is bound to extend into the political field. There is in fact no clear boundary between the economic and the political. War and the prevention of war count as political issues, yet war is inextricably connected with economic policy. Not only is the clash of economic interests often the cause of war, but economic resources are an essential constituent of fighting power. The present generation has become dreadfully familiar with the stress of total war, war, that is to say, the demands of which on a combatant's economic resources admit of no limit short of exhaustion.

The economic life of a community is directed by institutions the framing of which is a political process. Democracy is a political institution, but the freedom and equality for the sake of which democracy was called into being are as much economic as political ideals. If at the present day democracy is called in question, that is because the shortcomings of economic institutions are visited upon it. Attacks on democracy have developed, as they could hardly fail to do, into

attacks on liberty. Liberty is a time-honoured cause, but for that reason has lost some of its glamour. Clear systematic and objective thinking is needed to reawaken the appreciation of liberty.

The scope of our subject is very wide, and its ramifications many and varied. To give unity to the whole, a preliminary survey will be desirable, and that is the purpose of this first chapter. The several sections of economic life in which the maladjustments of recent years have been experienced will then be examined in turn in greater detail. And in the second half of the book (Chapter XIII to the end) we shall consider the possible changes in which remedies are to be sought.

2. It will be convenient to start our preliminary survey with some observations on the delimitation of the subject and the meaning of the term 'economic.' Traditionally the subject-matter of economics has been defined as Wealth. Wealth includes only those possessions which have exchange value, and exchange value presupposes a limitation of supply. The air we breathe has no value in this sense, and a thing which usually has value may have none at a place where for the time being there is a glut of supply.

Some economists have thus been led to define their subject in terms of 'scarcity.' It treats, they say, of the allocation of scarce or limited means of attaining desired ends. The definition is simple and logical, and *suitably interpreted* it comes near what is wanted. But when we look into it we find that *human activity itself* has to be reckoned among the 'limited means.' A desirable object which requires human action to produce it has value in the economic sense so defined, because it cannot be had in unlimited quantities.

A definition which makes economics coextensive with human action is obviously too wide. Human action is the means to *all* ends, and the supply of it is limited, not merely when the action calls for some special skill, which may command a scarcity value, but even when it is something that anyone can do. Whenever a man decides how to employ his time, even for his own enjoyment or convenience, his choice is in the allocation of limited means to the ends he desires.

It is not all human action that is the subject-matter of economics; it is that particular kind of human action which is called 'work.' A word so familiar to popular usage cannot be expected to supply a scientifically precise definition, yet it does come very close to the delimitation we are seeking.

Work is the kind of action that is done for some ulterior motive, especially, but not exclusively, for payment or material reward. It is distinguished from leisure, which means the time occupied not only by idleness, but by actions performed spontaneously for the sake of their direct results, and not needing the stimulus of any extraneous motive. Even when the direct result is the motive, the action may still count as work, if the result is sufficiently remote from it, as when a man

works in his garden or learns to sing. Work, it is true, is not the sole constituent of economic activity. Work produces wealth, and whenever the product is not simply a service rendered but is a tangible object, the work is applied to some material supplied by nature. But in order that any such material may become a product, work in the economic sense must be done on it; even the act of selection, involving no effort, but only a decision, counts as work.

The extraneous motive for work is not necessarily or exclusively gain. Slaves work under compulsion. In primitive communities tasks are allotted by custom and tradition so that neither reward nor compulsion may be required.

More of the primitive method has survived in modern man than is sometimes perceived. Performance of the duties of the family is to some extent enforceable by law, but compulsion is not the principal motive. The family is founded not merely on immemorial tradition but on elemental instincts. The services rendered by husband and wife both to their progeny and to one another are in themselves as exacting as the work done for gain, though they do not depend on gain as a motive, and cannot be measured in terms of marketable value.[1] The nation is an enlarged family, and relies on loyalty and patriotism as springs of action in affairs of national concern, especially in time of war or national peril.

Work is the kind of action that is not performed spontaneously for its own sake. If it has to be performed at all, and some extraneous motive has to be attached to it, that is because it serves some ulterior purpose. The purposes to be served by work are a matter of public policy. The institutions of a community decide not only by what motives work is to be actuated but to what ends it is to be directed.

In the eyes of the classical school of economists, from Adam Smith to Marshall and Marshall's present-day successors, the primary purpose of work is to produce goods and services for sale in a market. The fact of sale is evidence that the goods or services meet the needs of the purchasers. The marketing process, which measures the value of the product, at the same time provides the reward of the producer.

Adam Smith began *The Wealth of Nations* with an account of the division of labour. His example was the manufacture of pins, which, as he estimated, required eighteen different processes, and could be done far more efficiently if each process was entrusted to a separate group of workmen, than if each workman had to perform all. That is to say, a given number of workmen could produce far more pins in a given time, and with given assiduity, by a division of labour.

The division of labour is fundamental in economics. It is not merely a device for saving labour and increasing output, for a very great part of the products of a civilised community could not be produced

[1] See *The Economic Problem*, chapter xiv.

without it at all. The use of capital in production is one application of it; the instruments of production, appliances which save labour or add to its efficiency, have to be produced before they can be used, and there is a division of labour between the producers of the instruments and those who use them. International trade was approached by Davanzati, in the opening pages of his *Lezione delle Monete*, as an extended application of the division of labour, long before Adam Smith's day; it permits of things being produced and processes performed in the places best suited to them.

It is the division of labour that is at the root of the economic conception of work. He who specialises in one kind of product or in one process contributing towards the formation of a product must receive some remuneration other than the product itself, for he needs for his consumption not one product but many. That is the function of *exchange*.

3. A market is essentially a device for effecting the exchange of one product for another. In practice products are not bartered but are sold for money, but money intervenes as a medium of exchange, so that the seller is eventually exchanging what he sells for what he buys. The wage-earner or salary-earner sells his services in the labour market to an employer, and spends his earnings on the things he wants. The trader buys goods and services and sells his product, realising, by way of a surplus or profit, an income which he can spend on himself.

The market is an organisation by which prospective buyers and sellers are brought together and made aware of one another's offers. If the sellers of any product are informed of the prices offered by the buyers, and the buyers are informed of the prices asked by the sellers, no one will sell at a lower price or buy at a higher price than anyone else. So long as a market works perfectly, there is a single determinate price of the product at any given place and time.

This singleness of price gives rise to the conception of wealth as something *measurable*. Marketable products can be regarded as an aggregate, with the money unit in terms of which they are priced as their common denominator.

The process by which the market eliminates inequalities of price is that which is called competition. And the economic system, which makes wealth both the end of economic activity for the community and its motive for the individual, may be called competitivism [1] or the competitive system.

The characteristic of competitivism is that it proceeds with a minimum of interference from authority. In general the combination of the activities of a number of people in the pursuit of an end demands leadership and conscious guidance. But the competitive system, as conceived by the classical economists, worked itself; it was the

[1] That is a more directly descriptive term than 'individualism' or 'capitalism.'

principle of *laissez-faire*, or 'let-do.' True, they did not pretend that it would cover the entire field; they recognised that there were certain spheres where the principle of free competition had to be modified by the intervention of authority. But in their eyes these were no more than excrescences on the general principle, and did not detract materially from it.

An organised community is a disciplined community. Slavery is a form of discipline. So is primitive tribal custom. Feudalism was a development of tribal custom, associating political authority with land-ownership, and based on a discipline that took the form of allegiance at the top and serfdom at the bottom. Free competition reduces discipline to the narrowest limits. It asks only for the enforcement of the rights of property and contract, and the protection of the individual against fraud and violence.

Competitivism was advocated by the economists of the eighteenth and nineteenth centuries as a way of emancipation from a tangle of obsolete feudal restrictions and invidious rights. Not only the local land-owners' rights, but the rights and privileges that had in course of time been accorded under feudal authority to traders, municipalities and other agencies, had become vexatious and onerous. The advantage to the possessor of a right or a privilege was often quite insignificant in comparison with the burden imposed by the corresponding obligation or restriction.

The economists' case therefore was not comprehensively against interference with freedom in itself, but was in practice rather against existing *misdirected* interference. The liberation of economic activity from interference was no more than a negative policy. As it approached accomplishment in the nineteenth century, the adequacy of the competitive system as a positive policy soon came to be challenged. Every defect disclosed became a potential ground of change, and since the turn of the century change has been gaining more and more momentum.

4. It is sometimes maintained that ethical considerations ought to be excluded from economics, and that the economist should confine himself to the study of economic behaviour without criticising the ends to which it is directed. But a positive science of economics so conceived is a false abstraction. Even if the economist can disavow all concern in what is good or bad, he cannot carry his science very far without distinguishing what is important from what is less important or trivial. And things are 'important' only in proportion as they are *either* good *or* bad (whether as ends or as means). He cannot even select topics for investigation without applying this criterion.

He may, it is true, be asked to advise how economic resources are to be employed for some specified end, and can answer without criticising the end. But even so he cannot treat all considerations of good

and bad other than the end as irrelevant. Even though he must accept the end itself as decided on, whatever his view of it may be, yet he will be expected to recommend the most desirable or least undesirable means of attaining it.

Economics in fact cannot be dissociated from ethics. And in practice economists have always had what is desirable in view. As the end of economic activity competitivism offered a pool of wealth, into which everyone might dip, to receive a share in proportion to his pecuniary resources. At first it was taken for granted that wealth was desirable, that it was a worthy end. As economic science developed, misgiving was felt as to the adequacy of this assumption. Wealth was no more than the means of serving certain human needs, and the idea of utility or the power of serving needs was introduced. Wealth, it was held, was desirable for the sake of its utility.

Wealth is measurable by reference to its market value in terms of units of money. Utility was likewise conceived of as measurable. But the utility of any portion of wealth was not in proportion to its amount as measured by market value. A product of which the supply is abundant will be sold at a very low price, even if its utility as the means of meeting a human need is of the highest. In the extreme case a thing, such as air, which is essential to life, may command no price at all, and will not count as wealth.

What market value indicates is the consumer's preference. When he buys a thing for a shilling, he is assumed at the moment to prefer that particular thing to anything else on which he might have spent the shilling. What is implied is an order of preference, but not necessarily any measurable quality forming the ground of preference. If the consumer applies his preferences wisely, so that he could not get greater satisfaction from any shilling of his expenditure by employing it on a different purchase, he may be said to attain the maximum satisfaction that his pecuniary resources can be made to yield him.

Thus the end appointed by competitivism for economic activity or work is the maximum satisfaction of the individual in exchange for his money. Consumers admittedly may not apply their preferences wisely, and, even in so far as they do, maximum satisfaction is not the same as maximum welfare. Nevertheless the competitivist would contend that the free preferences of the individual are likely to attain the best practicable approximation to his maximum welfare.

That is not a contention to be accepted without qualification. But, even if it were, the principle of maximum satisfaction of the individual does not pretend to maximise the welfare of all the individuals composing the community. There are wide inequalities of income and of possessions. In so far as satisfaction corresponds to welfare, the welfare derived by a wealthy man from a shilling's outlay is likely to be far less than that derived by a poor man from the same sum.

Welfare is not susceptible of numerical measurement even in a comparison of different experiences of one and the same individual, still less in weighing the experiences of one individual against those of another.[1] But, for all that, comparisons of greater and less welfare are not merely possible, but are essential to the conduct of life. Such comparisons are complicated by the presence of imponderables which are not always easily discerned or appreciated, but they are constantly made by everyone. Your duty towards your neighbour is to promote his welfare. That is the basis of all civilised moral codes.

The acquisition of wealth may contribute to the possessor's welfare —but the mere fact that it meets his needs or gives him satisfaction, or that what he gets is what he prefers to possible alternatives, is not decisive. There are higher and lower propensities and desires. It may be that the lower give less real ' satisfaction ' than the higher, and that perfectly enlightened self-interest would genuinely aim at a maximum of self-welfare. But, even if that is so, yet, so long as there are wide inequalities in the distribution of wealth, the maximum satisfaction of every individual will fail to yield the maximum welfare of all. In general the efficacy of wealth to promote anyone's welfare tapers away rapidly as the amount of wealth he enjoys increases, so that the amount of welfare generated by the superfluities of the well-to-do is far less than that which an equivalent amount of wealth (in terms of money value) would bring to those of small means.

That is not universally true. For the capacity of the individual to make use of wealth varies. Not only may the rich man use his superfluity in leisure activities which, though unpaid, are beneficial to his neighbours, but one man may be better qualified than another to make an appreciative use of the opportunities of superfluous wealth, whether for others or for himself. If inequalities of income were governed by people's relative qualifications for wise spending, they might be reconcilable with the maximum of welfare, provided the superfluities of the aristocracy of culture did not encroach on the means of meeting the elementary needs of the mass of people.

They might. But, as things are, those conditions are not fulfilled. There is no direct relation under the competitive system between money-making opportunities and wisdom in spending. When a family is enriched, it ought to be able to acquire an appreciation of the refinements of welfare in successive generations, even if it is no better qualified for doing so than the rest, and to some extent this does occur. But fashion and convention usually supply standards of spending calculated to absorb any income, however large, with very little to show in the way of welfare.

[1] I should hesitate to say dogmatically that welfare is not measurable, but at any rate we do not measure it, and we know of no unit or standard by which to do so.

Even if the aim of competitivism be limited to the maximum satisfaction of the individual, it demands enlightened self-interest on his part. He must know what he wants. In practice there is little system in his selection. Most people are very susceptible to suggestion in their spending. Traders exploit this weakness through all the devices of salesmanship and advertisement. They thrust opportunities of expenditure on their customers' attention or insinuate them into their minds, and the customers' choice is easily led. That applies to rich and poor alike, but in the case of the poor the urgency of primary needs does make itself felt. The richer the man, the more likely is his expenditure on himself and his family to drift in the wake of ostentation, levity and futility.

Inequalities of wealth have perhaps been the ground of the most conspicuous attacks on the competitive system. To correct them, recourse has been had to heavily graduated direct taxation, taking for the State far higher proportions of the resources of the rich than of the poor, and also to the application of a large part of the revenues of the State to the social services, that is to say, to expenditure incurred to supplement the resources and to promote the welfare of the wage-earning classes.

5. But this is only a part of the encroachments on the competitive system. It is not merely the inequalities themselves that are attacked, but the methods of money-making that the system rests upon. The need for some modification of the competitive system in its application to local monopolies, particularly those that occur in the case of transport systems and in public utilities (such as the supply of water, heating, lighting and sanitation), has always been recognised even by its most uncompromising advocates. And the modern tendency of economic activity towards organisation in very large units has given rise to interests with some of the attributes of monopoly, independent of any local advantages or limitations. But it is by no means exclusively these tendencies to monopoly that are the target for attack. The competitive system is built up on the initiative of the profit-making trader. Profit is relied on as the indispensable incentive of enterprise. And profit, as we shall see, is an anomalous and invidious feature of the system. Even where no element of monopoly in the strict sense is present, profit-making is far removed from that apportionment of income according to merit among those contributing to the resources of the community, which is the ostensible ideal of the competitive system.

As enterprise has come more and more into the hands of the profit-making employers of wage-paid workpeople, the complaint that the employers are exploiting the workpeople has become more and more insistent. The defence of the wage-earners' interests has been organised through trade unions.

Organised labour is probably an indispensable feature of the competitive system. Without it there would be nothing but the employers' competition to ensure the fair working of the labour market, and competition gives place only too easily to combination, tacit if not open, among the employers. At any rate in the past century workpeople have come to rely more and more on combination in trade unions, especially to obtain the advantages of collective bargaining in settling rates of wages and conditions of employment.

But however desirable and necessary it may be, organised labour is yet quite alien to the principles of competitivism. Every trade union is an approach to monopoly. When the labour employed in any productive process is organised, its power can be exercised at the expense of consumers of the product as well as at the expense of employers. And when the recruitment of an industry is restricted, the gain of the privileged workmen is at the expense of those who are unorganised or who are engaged in industries less favourably placed for monopolistic exploitation.

The principle of collective bargaining is that the workpeople in any industry or craft can refuse as a body to work for any employer who will not grant them the wages and the conditions of labour that they stipulate for. If all the employers in the industry are organised and act together, disagreement will result in a strike throughout the industry and a complete suspension of its operations. Employers and workmen are thus involved in a combat in which, though violence is not permitted by the law, each party is endeavouring to inflict injury by stopping the source of income of the other.

This is something different in kind from the behaviour of people engaged in ordinary bargaining over anything offered for sale, where one can refuse to buy or the other refuse to sell without inflicting positive injury. In a labour dispute the employers seek to reduce the workmen to destitution, the workmen to involve the employers in greater loss than they can stand. And the complete interruption of an industry may involve the community in general in inconvenience or, if the industry is an important one, in grave distress. There is even a temptation to put pressure on the community in this way to gain concessions by political means for the workpeople in an industry producing an article of necessary consumption.

This procedure, approximating to a state of civil war, is only tolerated because there is no independent and generally recognised standard of what is fair in wage agreements. The absence of such a standard is a grievous fault in the competitive system.

6. Yet another failure imputed to the competitive system is in the monetary sphere. Economic activity is governed throughout by the pecuniary motive. All bargains and agreements are expressed in

money, and their significance depends on the wealth value of the monetary unit, that is to say, its value in terms of goods in general.

In the nineteenth century the competitive system relied on the gold standard as the regulator of the value of the unit. The free coinage of gold, combined with freedom to melt gold coin and to export and import gold, provided a currency which was interchangeable with the commodity, gold, so that the wealth value of the monetary unit was equal to the wealth value of its equivalent in gold.

Admittedly perfect fixity of value of the unit in terms of goods was not attained by the gold standard. The wealth value of gold itself was liable to vary in consequence of the scarcity or abundance of the supply of new gold from the mines, and still more in consequence of changes in the *demand* for gold as money.

These changes in demand were greatly accentuated by the development of credit and especially the increased use, as a means of payment, of bank credit, that is to say, debts due from banks, which are assignable from one creditor to another by means of bank-notes or cheques. Bank credit at first supplemented and then superseded coin as the principal medium of payment. Banks could create their own indebtedness and so possessed a dangerous power of multiplying the means of payment.

The banks remained under an obligation to pay their indebtedness in coin, and gold therefore remained the ultimate regulator. But wide fluctuations in the supply of the means of payment could develop before the limiting effect of that obligation was felt.

The system became centralised. Reserves were pooled with a central bank which was given a practical monopoly of the issue of bank-notes, and assumed the function of lender of last resort, undertaking to assist any solvent bank which was in need of currency. The banks expanded or contracted credit as their reserves were greater or less, but their reserves depended on the action of the central bank.

In any country in which this centralisation occurred, the management of the currency devolved on the central bank, which had the power to create paper currency. That was a departure from the competitive system. Banking opinion was reluctant to acquiesce in it, and the Bank of England remained proud of its independent status as a company owned by its stockholders. But the Bank has long recognised that it must be guided by considerations of public policy and not of profit-making. Administratively it is an organ of the Government, however independent it may be of ministers and of departments.

So long as the central bank could regulate its action by a single-minded aim of maintaining its gold reserve at what was judged to be the appropriate proportion, it could be plausibly argued that there was no material departure from the plain principles of the metallic standard. The Government, it might be said, still limited its interference to the supply of a reliable coinage, and the central bank merely

canalised the forces that would equally have operated in a decentralised system.

7. Up to 1914 this was a tenable interpretation. But even in that period the centralised responsibility for credit regulation was giving rise to problems. Adherence to the criterion of the gold reserve was no safeguard against quite considerable fluctuations in the wealth value of the monetary unit. Credit expansions were given free play for a time, with a resulting rise in the price level, and the gradual outflow of currency into circulation would only cause too tardily such a reduction of metallic reserves as would give the signal for a credit contraction.

The credit contraction or deflation, when it came, took effect in a reduced flow of money and a flagging demand, which involved not merely a fall of prices but an epidemic of unemployment and all the concomitants of trade depression.

Monetary policy and trade depressions have become the subjects of unceasing controversy. But the fact that deflationary measures, if successful, must cause depression and unemployment is, I think, common ground to all parties. And even those who attribute fluctuations and depressions to causes outside the monetary sphere recognise that account must be taken of monetary policy in any remedial or preventive measures.

In recent years monetary fluctuations have become more violent and depressions more severe. And the general displacement of coin by paper currency as the hand-to-hand medium has emphasised the central responsibility for monetary policy.

If monetary policy were wisely conceived, it would be directed to a stabilisation of the flow of money; by avoiding an excessive expansion or inflation, it would escape the necessity for deflation as a corrective. The blind empiricism of monetary authorities has inflicted on a great part of the world the excesses of inflation and the agonies of deflation on such a scale that unemployment has become the outstanding economic and social problem of the time. Of all the defects of the economic system it is this that usually heads the indictment.

Unemployment may arise, it is true, from economic causes of a non-monetary character. Any sudden or discontinuous change in economic conditions, which calls for diminished activity in some industries, will make a part of the labour employed in those industries redundant. The displaced labour cannot immediately be employed in other industries. But that state of things is not peculiar to the existing economic system. It is liable to occur under any system.

The competitive system, however, makes the means of livelihood of the individual and his family dependent on his power of contributing to the economic activity of the community. He who has no resources other than his own labour is faced with starvation when he loses

employment. The pure competitivist doctrine would teach that the spur of need is the most effective driving force to impel people to find new employment without delay. But no community would be willing to rely on starvation as an institution. Some provision for those who through any misfortune cannot support themselves is essential.

Here is a dilemma. Relief must be given to those unable to provide for themselves, not only to those who are unfitted on account of age or physical disability, but to those who have lost their occupation, whether they are wage-earners out of employment, or those working on their own account whose product has ceased to find an adequate market. But if the relief is fully equivalent to the income lost, the motive to find new opportunities, on which the competitive system relies, is destroyed.

One solution is to restrict the relief to a minimum, a bare subsistence which is so unattractive in comparison with active earnings that the stimulus to work is not much diminished. Alternatively there may be a centrally organised employment exchange system, and relief on a more liberal scale may be made conditional on willingness to accept suitable employment when offered.

Such a central organisation is one more exception to the general rule of reliance on free competition, but quite as legitimate as the regulation of local monopolies, and it is not inconsistent with the retention of free competition as the main principle of the economic system. It does not offer a remedy for unemployment but only a palliative, but in this respect any other economic system is in much the same case.

The general unemployment caused by monetary deflation is remediable. It calls for positive action on the part of the monetary authorities. Perhaps the unwillingness of central banks to accept the responsibility for so managing the monetary system as to avoid deflation is itself an outcome of the competitive system, of which an automatically adjusted metallic currency was formerly a feature. But once a central authority for the regulation of credit and money has been evolved, the competitive system is no obstacle to its being wisely directed.

8. Closely related to the monetary side of economic activity is the process of capital accumulation. The competitive system leaves the individual to decide how much of his income he will spend and how much he will save. Under the conditions that have obtained since the beginning of the nineteenth century savings practically constitute the resources available for capital outlay.

Capital outlay is one of the principal constituents of economic progress. The productivity of a community is increased by technological improvements, by improvements of organisation and by acquired skill among its people, but these improvements are to a great extent conditioned by the supply of material aids to production. That

is especially the case with technological improvements, which often take the form of labour-saving appliances. A community is enriched by equipping its people with such appliances, each in succession releasing labour for new forms of production, for which in turn more material equipment is needed. Even apart from new inventions, a given state of technological knowledge may permit of an almost indefinite extension of instrumental capital, so that the limit is imposed only by the extent of the resources arising from saving.

Under the competitive system it is the function of the investment market to adjust capital outlay to the available saving. Any divergence between the two has repercussions on the credit system, and the amount of saving is itself greatly dependent on the state of the monetary situation.

The rate of progress of the enrichment of the community by the growth of its instrumental capital depends upon the decisions of individuals as to the amount they choose to save. The selection of projects for capital outlay devolves upon promoters and traders, whose motive is to make profits ; where the selection is made by public authorities, such as the Government, local authorities, or statutory boards managing public utilities, these are exceptions to the competitive principle.

All these different aspects of the methods of accumulation under the competitive system are subjected to hostile criticism. The selection of projects for capital outlay by the test of prospective profit reflects the imperfections of market value as a measure of welfare. But that is merely one aspect of a fault we have already considered. In any economic system capital outlay is one of the productive resources directed to whatever end is in fact aimed at. It is claimed in favour of competitivism that it does attract capital resources into the channels where they are needed, whether because the demand for a product is intensified so that an extension of the capacity of the industry producing it will be remunerative, or because new appliances of high cost-saving power have become available. In principle the claim is justified. But the working of the system is apt to be extremely wasteful. Where new processes or new products are involved, an estimate of prospective profits is often so uncertain as to be a mere gamble. Where the command of money and expert knowledge are combined in one individual, there is less uncertainty and the advantages of the enlightened self-interest on which competitivism relies are in some degree realised. But this combination does not cover the whole field, and those who possess it are able to derive big monopoly gains from their position in the favoured circle.

Outside the circle investors with money and without expert knowledge have to rely on intermediaries. Many are content to put their money in loans on which they get interest only, and thus to contract out of any gamble on profit. But the resources of those who look for

shares with a yield swollen by profit are considerable enough to be an important influence in the market. If these resources all received the guidance of honest, skilful and prudent intermediaries, they might be led into the path of enlightened self-interest. But markets are so organised that the prudent investor buys shares in a concern already established, and pays a high price for capitalised profit or goodwill, while the more speculative investor who plunges into untried new flotations is too often at the mercy of the promoter, who exploits his ignorance by a plausible presentation of prospects that are in reality at the best very uncertain. The result is very great waste. The wise men of the inner ring get most of the successful enterprises into their own hands, and make big fortunes. But even of their money much is likely enough in the next generation to swell the resources to be exploited by irresponsible promoters. Not only does the misapplied capital outlay fail to yield the profit which under the competitive system is the criterion of usefulness, but a heavy toll is levied on the investors' money by the intermediaries in the form of commissions and profitable participations.

The amount of accumulation depends on the individuals' decisions to save. He who is guided by enlightened self-interest should decide his saving by a comparison of the present and future resources and needs of himself and his dependants. Accumulation in the aggregate is the resultant of these motives; it amounts to what those among the population who receive incomes think prudent to save on personal and family grounds. And that seems to be a not unreasonable solution. If each man separately is satisfied, then all are satisfied. If satisfaction is not attained, that is because individuals are not sufficiently far-sighted, or because they miscalculate.

9. But individual satisfaction, even if it were attained, would not be a complete solution of the needs of accumulation. This is a field in which the community itself has needs. Accumulation provides not only for reserves of wealth of individuals but for the material equipment of the community. And material equipment comprises not only the instruments of production but the material equipment of national power in war.

And here we approach a subject which far transcends the question of accumulation. We have been discussing welfare as an end of economic policy. Welfare in its fullest sense, the good life, is the only right end. Yet the organisation of humanity in nations is so inherently anarchic that welfare cannot take the first place. It is subordinated to the means of attack and defence. Whatever a nation possesses it possesses on sufferance unless it can defend itself against attack.

The power of attack and defence is founded on material resources. That is not to say that military skill and courage and other imponder-

ables are not also of the first importance. But material resources are likely in the long run to be decisive. That has always been so. Throughout history the great military powers have been those which could not merely levy but could organise, equip, provision and transport great forces. But the present century has seen the advantages of great material resources in war increased beyond all measurement. Invention has pointed the way to an ever-growing elaboration of warlike equipment ; industry has been so organised that it can be concentrated as never before on the forms of production needed for this equipment ; the means of transport have been devised for assembling the whole fighting power, human and material, of a great nation in one decisive field.

In a trial of strength with a formidable adversary a nation must be prepared to exploit its entire economic capacity. In its early days the competitive system stood this test well. The removal of the restraints of feudalism let loose a flood of profit-making and accumulation, and the fiscal machinery and investment markets of the nineteenth century placed in the hands of the State a command of resources sufficient to pay for whatever war effort was technically possible.

In the twentieth century the limit of what is technically possible has been enormously extended. The fiscal machinery has itself been improved. In the nineteenth century a tax revenue of one-tenth of the national income would have been regarded as high ; nowadays one-fifth is becoming normal, and the limit under war conditions is nearer one-third than one-fourth. And these onerous fractions are ever so far below national needs. They must be supplemented by an enormous volume of savings lent to the Government.

But in any case the competitive system is not adequate to accomplish such a task. The Government cannot rely on merely raising money and setting out to buy the goods and services it needs in a free market. The simple negative discipline of competitivism has to be reinforced by a more positive regimentation. Those who can render the services or supply the goods needed must be *commanded* to do so ; they cannot be allowed to bargain over the price, and to choose how much they will do or whether they will do anything at the price offered. The exigencies of a country at war override all such considerations.

The classical economists were disposed to treat war as an exceptional vagary, an unfortunate excrescence on an economic system otherwise devoted to the pursuit of utility under the guise of wealth. So long as the maximum war effort technically possible was within the capacity of the fiscal expedients of competitivism, that was not too far from the truth to be a plausible and indeed useful hypothesis. Yet there was even then such a divergence between the theories of the economists and the principles of action of Governments as to vitiate the practical application of the former.

From time immemorial power in war has been the paramount aim of Government. With given numbers and given endowments of courage and military skill, power in war could be almost indefinitely increased by adding to the national resources. Not merely could the forces be better armed, but a greater proportion of a given population could be equipped, provisioned and transported, and force could be brought to bear at a greater distance.

These advantages depend on the form as well as the mere magnitude of the country's resources. Foreign trade has always been especially valued, as yielding high profits and liquid funds, and forming the foundation of international financial power. And when it takes the form of oversea trade, it supports a merchant fleet and provides the elements of sea power. Foreign trade also enables a country when at war to draw upon neutral resources.

Accumulation in itself is an increase in resources. But it takes forms which vary considerably in adaptability to war-time purposes. In ancient and medieval times there was no investment market and instruments of production were a very limited field. Accumulation consisted mainly of consumers' instrumental goods, agricultural improvements, traders' stocks and the precious metals. To the mercantile communities, such as Venice, Florence, and the Hansa towns, merchants' stocks were an important resource, and came to be associated with intangible financial assets in foreign centres, which, even on the modest scale of medieval finance, were a great source of power. But as a medium of accumulation and a reserve for the expenses of war the precious metals were pre-eminent.

Modern technological progress has opened up a vast field for capital outlay in the mechanisation of industry and transport, and the evolution of the investment market has conferred the attributes of liquidity on the securities in which rights of participation in capital are embodied. Accumulation has become through mechanisation the means of almost indefinitely increasing the power of manufacture and transport, and these operations can to a very great extent be adapted when required to the purposes of war. The investment market has reinforced the fiscal machinery of Government with the means of borrowing on a large scale in an emergency, and it has created a new branch of accumulation in the form of external investment. When people have been investing abroad in marketable securities, it is possible to draw upon neutral resources in war time by selling these securities as well as by borrowing abroad.

Accumulation under the competitive system is a haphazard process. In the nineteenth century it grew apace, and Governments were content to step aside and see it grow. The experience of the war of 1914–18 revealed both the importance of accumulated wealth as the foundation of military power and at the same time the limitations of accumulation

as it had prevailed under the reign of let-do. It had become possible for the war effort to strain a nation's resources to the limit of exhaustion. And if it was possible, it was necessary. No belligerent could afford to acquiesce in an effort less than the maximum.

To adapt the resources to the effort took time. All the countries engaged were unprepared, and both the economic strain and the slaughter had to be protracted.

When it was over, the victorious powers were animated by a detestation of war and armaments. They imposed a drastic disarmament on the defeated, and, not needing to arm against one another, they set up the League of Nations in the hope of establishing a reign of peace. They relapsed in fact to the state of unreadiness for war on the modern scale which had prevailed before 1914, and looked forward to an agreed limitation of armaments. When the League of Nations broke up and the limitation of armaments broke down, the world suddenly reverted to the position of 1914, but with a vital difference. It had come to be recognised that, in the absence of the League or an equivalent, peace is potential war, and that the economic system must be permanently adapted to the strain of war. Specialised industries on a gigantic scale had become necessary to the modern panoply, and any country which gained a lead in peace time in the establishment of these industries would have a fatal advantage in the event of a conflict.

That had always been true of naval power. From 1815 onwards British naval supremacy was securely founded on peace-time establishments. It was never seriously threatened by French competition. The attempt of Germany to challenge it was a powerful contributory cause of British participation in the war that broke out in 1914. In 1935 the technical necessity for peace-time preparation had become as imperative in land and air warfare as in sea warfare. Germany led the way in recognising this new situation.

Russia and Italy had already afforded examples of the discipline of a totalitarian State, a discipline imposed by a party banded together by party loyalty in pursuit of a common cause. When all rival parties are repressed, and the adherents of the dominant party find their ambitions and livelihood irrevocably tied up with its fate, the bond of party loyalty acquires an unassailable strength, and, if the adherents are numerous and distributed throughout the community, the discipline can be enforced with far greater rigour than when it rests on no more than the routine law-abiding propensities of a tranquil population supervised by a professional police.

It was a discipline of this type that the National Socialist Party called in aid to engage the productive resources of Germany in a programme of rearmament of unparalleled magnitude. Germany set the pace for the other Great Powers. The tremendous competition in armaments that ensued quickly led up to actual war.

But it would be a mistake to see in such competition no more than a preliminary to actual war. Even in peace a nation's influence depends on its potentiality in war. Diplomacy is war without the fighting. The rights that emerge from it are the rights of the strongest. Any country which has superior power can coerce its neighbours and take from them whatever it chooses. So long as they recognise its superior power, it need not resort to actual war. The only limit to its depredations is the power of rivals, that which history calls a balance of power. The balance of power is partly geographical. The power of attack of any country diminishes with distance. When a conqueror overturns the balance of power, his sphere of influence still remains subject to limitations. The Roman Empire, when it superseded the balance of power in the Mediterranean countries and western Europe, accepted geographical limits beyond which it could not make its strength effective.

The hegemony of a conquering country over a wide area has repeatedly occurred in the history of the world, but it is nevertheless an exceptional state of things. A balance of power secured rather by armaments than by geography is more usual. Even the Roman Empire preserved only an imperfect unity, broken from time to time by civil wars and rebellions.

In the modern world the balance of power has been the foundation of international relations. There was a limited circle of Great Powers, each of which was reputed to be so strong that no one of the others could attack it without serious hazard. Sometimes the powers were grouped in alliances. No power or group of powers could afford to let its rivals strengthen themselves at the expense of the weaker or smaller countries outside the circle. It was in fact the balance of power that secured the independence of these latter.

The League of Nations only partially disestablished this system, and the defection of Germany and Italy brought it into play once again. There had been no formal limitation of armaments (except among navies), but there had in fact been no competition in armaments till 1935. The reversion to the balance of power system in that year precipitated a competition such as the world had never known before.

A competition in armaments which so strains the resources of the competitors that they cannot sustain it indefinitely is almost inevitably the prelude to war. A country that feels itself to have insufficient staying power precipitates war rather than be outdistanced by its rivals. And the armament race which started in 1935 may be interpreted as no more than the preparation for the war which started in 1939.

But what is to follow? Are the international relations of the world to be governed in the future by the balance of power? Technological progress has almost destroyed the geographical barriers. If every

great power is within the reach of every other, all must be armed. In default of an agreed limitation, how is the burden of armaments to stop short of the maximum that can be borne?

Competitivism has already been strained in peace time by the burden which the social services throw on the State. The strain appears in the public finances; people have to give up to the State a substantial and growing proportion of the incomes that the competitive system yields as the reward and incentive of their economic activities. If the burden of armaments is to increase this strain indefinitely, can competitivism survive? The strain is felt first in the fiscal system, but beyond that there is the possibility that the simple and happy discipline of let-do is fundamentally inadequate, and that nothing but a totalitarian regimentation will equip a nation with its maximum power in war.

Here is an economic destiny against which whoever has a spark of faith cannot fail to rebel—faith not in a narrow sense, but faith in any good. The condition of things in which peace is potential war, and the principal purpose of economic activity is the means of war, is intolerable in itself, and mankind cannot acquiesce in its being perpetuated. And, even while it lasts, it cannot be accepted as anything but a monstrous perversion of human society.

When the Jews returned after the Captivity and rebuilt the walls of Jerusalem, they were hard pressed by the attacks of Sanballat and the army of Samaria. 'They that builded the wall,' wrote Nehemiah, 'and they that bare burdens laded themselves, every one with one of his hands wrought in the work, and with the other held his weapon; and the builders, every one had his sword girded by his side, and so builded. And he that sounded the trumpet was by me.'

Perhaps humanity has to go through just such an ordeal, and perhaps a stricter discipline will be inevitable. But discipline does not necessarily mean repression or intolerance. Nor does it mean a departure from democratic government.

10. This conception of peace as potential war and economic resources as the means of war is the foundation of economic nationalism. And economic nationalism has in recent years made yet another breach in competitivism in the sphere of international trade.

The competitivism of the nineteenth century was associated with a removal of the regulations, restrictions and monopolies to which international trade had been subjected since the middle ages. And it advocated the abandonment of protective duties on imports, that is to say, duties designed to discriminate against imported supplies and in favour of home producers. The movement towards free trade in this sense made notable progress, but never became universal, and in 1879, when Germany under Bismarck reverted to protection, there began a widespread reaction.

Protection, being a measure of discrimination against foreign countries as such, forms part of the armoury of economic nationalism. In some aspects, it is true, the discriminatory motive counts for little. Duties with little discriminatory effect may be imposed for the sake of revenue. Where the discriminatory effect is substantial, the aim may be no more than a diversification of economic activity. Or again the restrictive effect of protective duties on imports may be sought on purely monetary grounds, to avoid the excess of imports and the unfavourable foreign exchanges which an over-expanded currency would otherwise cause.

It was the monetary motive that actuated the recourse to restrictions on international trade, which began in 1931 and were developed on a scale that had not been seen since the middle ages. World deflation had brought about a collapse of demand and a precipitate fall of prices, such as strained to breaking point the credit system of any country which sought to maintain the foreign exchange value of its currency unit. The fall of prices in world markets really meant simply a rise in the wealth value of gold, which could have been compensated by a reduction of the gold value of the currency unit. But, rather than accept that way of escape, many countries sought relief through a restriction of imports, not merely an imposition or increase of protective duties, but a quantitative restriction by quotas, or a foreign exchange control which restricted imports to what exports would pay for.

In this policy Germany led the way. And, when National Socialism brought totalitarian discipline and rearmament, the restriction of imports gained a new significance. Foreign exchange control was a far-reaching means of regimenting an industrial system which was largely dependent on imported materials and on export markets. And it was employed as a way of ending this dependence, especially so far as the importation of materials necessary for war from overseas was concerned.

The policy of self-sufficiency or autarky had gained a new importance from the experience of the war of 1914–18. The belligerent rights of the Entente Powers were so applied that Germany and her allies were prevented from importing supplies even indirectly through adjacent neutrals. They were put in the position of a beleaguered fortress ; and the resulting privations and shortage of certain materials contributed to their ultimate collapse. Possibly the contribution of this blockade was rather exaggerated in contemporary opinion. The strain of the four years' war effort was more than the German economic system could bear ; the privations were due as much to the excessive diversion of man-power and productive resources as a whole from agriculture and other civil needs to those of war, as to the shortage of imports. But undoubtedly some relief could have been obtained if

Germany's productive power could have been more economically applied through export to the acquisition of imported supplies, and still more if capital sums could have been raised abroad for that purpose by borrowing and sales of securities.

Whatever the precise value of the blockade may have been, it was widely believed to have been decisive. And when Germany turned to the task of rearmament, the restriction of imports that already existed became a rehearsal and a preparation for war conditions. The pressure being already experienced, there was time to search for remedies. Even under let-do a restriction of imports has the effect of stimulating the home production of the things that would otherwise be imported. Germany reinforced this effect by direct pressure on producers, by the establishment of Government-owned enterprises, and above all by research into the synthetic production of substitutes for natural products that would otherwise only be obtainable from overseas.

The exaggerated belief in the efficacy of an economic blockade influenced the course of events in another way. The League of Nations created by the Treaty of Versailles was conceived of as an institution for settling international disputes without the resort to war, but if it was to have the power of enforcing its decisions, how was it to avoid employing military force itself to restrain an aggressor or to coerce a recalcitrant? A solution was looked for in economic sanctions. It was hoped that if all loyal members of the League would cut off intercourse with an offending member, the latter would be compelled to give in without being exposed to actual warlike operations.

The occasion for applying economic sanctions arose in 1935. The Italian attack on Abyssinia was a defiance of the League, which could not be overlooked. Moreover no Great Power was so vulnerable as Italy to an economic blockade, and if economic sanctions were not effective against her they were never likely to be effective at all. They failed. But even the failure left behind a vivid sense of the need not to be so vulnerable in future. The movement towards self-sufficiency in war was accentuated.

Restrictions on foreign trade and foreign exchanges, once they have been imposed, are not easily removed or relaxed. Even before the outbreak of war in 1939 a great part of the world's trade had been subjected to them.

Restrictions on foreign trade are contrary to the spirit of competitivism, but in themselves are a self-contained encroachment on it, and are not inconsistent with the maintenance unimpaired of the competitive principle in the rest of economic life. But, as recently developed, these restrictions have supplied a powerful instrument for controlling almost the whole range of economic activity.

11. Since the end of the nineteenth century the competitive system

has exposed numerous openings to attack and the attack has been driven home. So wide and many have been the departures from it that we may well ask whether it has not already been transformed into something different. Ostensibly indeed profit-making is still relied on as the principal motive of economic action. But when to the encroachments of taxation, to the intrusions of monopolistic associations, and to the extensions of Government enterprise and social services, are added the paramount demands of economic nationalism, armaments and war, profit-making in competitive markets seems to be reduced to a circumscribed and subordinate sphere.

How far then is it either practicable or desirable to preserve the competitive system? If it is to be preserved, what departures from it are to be permitted or required? If it is to be abandoned, what is to take its place? These are questions to which the answers are contained in the economic destiny of mankind.

CHAPTER II

PROFIT [1]

1. So fundamental is the position of profit in the modern competitive system that we must take it as our starting point. It has been described in the preceding chapter (p. 9) as the indispensable incentive of enterprise, and yet as an anomalous and invidious feature of the competitive system.

Competitivism aspires to give everyone the share of wealth which a free market offers in exchange for the services he renders, in his person or in his property, towards the creation of that wealth. If everyone were either working on his own account or co-operating in a partnership, and the relation of employer and employed were unknown, that aim might be attained. Even then, quite apart from the abuses of monopoly, there would be much unmerited inequality due to the vagaries of demand.

If on that hypothesis the demand for a product were quite steady, those who supplied it could count on their incomes continuing unchanged. In case of a declining demand, the producers would have the alternatives of reducing their price or selling less. Either way their business would become less remunerative and, according to the competitivist theory, if the decline of demand were permanent, some of them would transfer their activities to more prosperous branches of production. But this transfer of productive power would in any case be a gradual process, and, when fluctuations in demand were believed to be temporary, it would not occur. There would be times, possibly prolonged, in some occupations and very likely in all, when the producers would be under-employed.

If a group of producers cannot sell their whole output, they must compete for sales. And their competition cannot be exclusively in reducing prices and offering better services. In a theoretically perfect market the buyers would be aware of what was being offered, and would spontaneously take advantage of it. Even so the reduction of price required to restore full production might be so great as to reduce the producers' incomes below subsistence level. There would be a price below which they would not offer their product, and would prefer to put up with under-employment.

Under conditions of under-employment there would be a competition of selling power. It is a consequence of the inevitable imperfections of a market that a trader's sales depend not only on the merits of the goods he sells and the terms which he offers, but on his skill and

[1] The theory of profit here propounded is that which I adopted in *The Economic Problem*, chapter iii. See also *Capital and Employment*, pp. 36–40.

assiduity in attracting buyers, and on the inertia which retains their custom once they have been attracted. In commercial parlance they depend on his power of creating and retaining his business connexion or 'goodwill.'

The trader with superior selling power gets more than his share of business. In the hypothetical economic conditions, where all traders are producers on their own account and not employers of wage-paid workpeople, the producer's selling power can do no more than secure him full-time occupation, though the lack of it may involve him in distress and privation.

But in a community organised in enterprises employing wage-paid labour, selling power becomes the source of far more flagrant inequalities. The output of one who works on his own account by his own unaided effort is limited, and he has no opportunity of expanding his selling power beyond the limit. But an employer of labour can enlarge his output in proportion as he enlarges the numbers he employs, and the task of selling is likewise enlarged. The enlargement is limited by the extent of his capital and by his capacity for organisation. One of the outstanding features of a modern economic community is the development of joint-stock enterprise, which facilitates the aggregation of the capital resources of individuals to equip large-scale concerns with the appropriate capital installations. And the resources of a big joint-stock company enable it to offer a correspondingly high remuneration for whatever organising capacity is to be found. It would be an exaggeration to say that there is no other obstacle to the expansion of enterprise than selling power. But the principal preoccupation of those who are establishing or extending an enterprise is the prospect of selling its product. The selling power of a new enterprise is a matter of estimate, and the capital and organising power that can be attracted into it will probably be limited to the resources of those who are in a position to exercise their own personal judgment about it. But when an existing enterprise is to be extended, its appeal for capital can be supported by the established facts of its actual sales. If the evidence is favourable, the appeal can almost count upon meeting with a response.

If capital and organisation are thus adjusted to selling power, it is selling power that governs the magnitude of the individual enterprise. That does not mean that the limitation on account of capital resources is inoperative. The initial size of an enterprise is limited by the resources that its promoters can lay their hands on; and if its subsequent expansion depends upon the realised demand for its products, the demand of which at any time there is tangible evidence cannot be indefinitely far beyond its then existing capacity. Expansion is therefore bound to be gradual, though in particular cases the rate of growth may be rapid, especially where the demand for some new thing is being exploited.

There will be wide disparities of magnitude among businesses. The scale of operations of each will depend on its selling power, though the extent and growth of its selling power will be conditioned by its capital resources.

2. Every trader who produces or purchases goods for sale, and incurs costs in his business through the employment of labour, the use of capital, the purchase of materials for manufacture or of goods for sale, or through any of these, finds his own remuneration in *profit*, that is to say, the excess of the proceeds of sale over costs.

If the cost per unit were the same for every business, large or small, the trader's remuneration would be proportional to his sales. But the margin of profit must be such as to secure an adequate income from the smallest businesses that remain in operation. For the larger businesses the incomes yielded will be *proportionately* greater. Costs are not always the same, but they tend, up to a point, to be less rather than more per unit of production in the larger concern. A limit may be set to the expansion of the big concern by the strain on the organising capacity of those who are responsible for it, and the complexity of the administrative services required. But in the modern world that limit is a wide one. Even if some businesses outgrow the organising capacity of the individuals in charge of them, and become involved in loss and failure, there are others which encounter no other limit to their enlargement than that of selling power.

The competitive principle does operate in the determination of the remuneration of the profit-making trader, but it operates in a distorted manner. Instead of equalising the incomes earned at a given level of skill and assiduity, competition equalises the profit margin, the difference between the cost and selling price of a unit of product. This margin provides the incomes from all the concerns in a trade or industry, large and small, and, if it is adequate for the small, it will be much more than adequate for the large.

Competition prevents the margin from becoming excessive, but only from becoming excessive in the sense of offering an excessive income to competitors, that is to say, to new-comers in the industry. The standard is set by a comparison of the income a new-comer might obtain with such alternative incomes as he might expect in other occupations not of the profit-making type. He might, for example, obtain salaried employment or enter a profession. If the comparison discloses a too favourable result, competitors will be attracted, the productive capacity of the industry will be enlarged, increased supply will reduce the price of the product and the profit margin will be diminished.

But in general the scale of operations of a new-comer can only be moderate, unless he is introducing some special novelty, whether of product or of process, for which a large capital and an extensive selling campaign would be forthcoming. Otherwise he must already possess

some kind of footing in the industry and his selling power is at the outset no more than a prospect. The capital he can raise, and indeed the capital he himself is willing to put into the business, will be limited by his prospective selling power.

But, it may be asked, even though these limitations apply to the potential competition of new-comers from outside, ought not the competition of those established in the industry to keep down the profit margin to what will secure each no more than reasonable remuneration? The economists of the nineteenth century were apologists for the competitive system. Profit was the skeleton in their cupboard, and much ingenuity was and still is employed to explain away its vagaries.

If the market works perfectly, any trader can get business away from his competitors by offering his product at a lower price. Those to whom the existing profit margin yields no more than an adequate remuneration cannot afford to cut prices any further, and will be driven out of business. If that is the way the market works, the survivors will go on undercutting one another till the profit margin is so reduced that none get more than adequate remuneration, except those who possess some exceptional advantage, such as special skill or a partial or local monopoly. That presupposes that (apart from exceptional advantages) expansion has gone in each case as far as it can profitably go; each business will have attained 'optimum' size. The incomes derived from the same profit margin and the same volume of business will be all the same. If any trader's income is exceptionally great, that must be either because his profit margin is greater (his costs being less or his product of better quality, whether through his own skill or through local advantages) or because his volume of sales *at a given price* is greater.

But here once more appears selling power. To suppose that all businesses approximate to a standard size, at which the profit margin yields no more than reasonable remuneration, is in reality to treat differences of selling power as inoperative. And to regard price-cutting as the sole or even the principal means of extending sales is to give a totally false picture of the working of markets.

The principle of competitivism is to assign a remuneration to every economic activity corresponding to its contribution to the productive process. Selling is one of these activities. The trader, in exercising his selling power, is discharging the vital function of seeking out the needs which his product is to meet.

For this service he has to be remunerated. But the remuneration the free market yields him, in the shape of the profit margin multiplied by the volume of his sales, is on a totally different principle from that by which the labour market determines the remuneration of services rendered when it takes the form of wage or salary. A salary is paid

for the whole time of a man with certain qualifications. If the qualifications are rare, the salary may be high—high enough in fact to limit the offers of employment to the number of qualified men by excluding the offers of those would-be employers who have to dispense with the service. The effect of competition is that substantially the same rate of remuneration is paid for the same qualifications, the differences, so far as not merely fortuitous, being due to the degrees of competence or experience of the recipients. If the magnitude of the business in which the man is to be employed has any bearing upon his rate of remuneration, that is only because, where his responsibilities are to be extensive, it is worth while to pay high for high qualifications. But payment *in mathematical proportion* to the magnitude of the business is altogether alien to the system. A captain of a big ship rightly gets higher pay than the captain of a small one, but in neither case is his pay reckoned at so much a ton. In trade, it is true, contracts of employment often allow remuneration partly in the form of a commission on transactions, but as a rule the opportunities of earning the commission are so limited that the total remuneration cannot greatly exceed the standard set by the market in salaries.

3. There is a division of function among profit-makers. If we use the convenient term 'traders' to include all profit-makers, all those, that is, who incur expense on buying or producing anything with a view to sale, we find that traders fall broadly into two classes, producers and dealers. Dealers are those who sell goods in the condition in which they bought them; producers are those who sell goods to which they have applied some process. Producers also include those who supply services, whether services rendered direct to consumers or services, such as the transport, handling and storage of goods, which contribute towards bringing goods into the hands of consumers.

The division between the two classes of traders is not hard and fast. Many traders who are primarily dealers, and are best classed as such, perform some of the services of handling, transport, storage and even minor manufacturing processes for themselves. And in the present century there has been a tendency for certain types of manufacturers to invade the province of the dealers and combine both functions.

A dealer in commodities has little fixed capital. His capital resources consist mainly of goods in stock, a 'working capital' which is always being turned over, as goods are sold and replaced by new purchases. This working capital is constantly fluctuating. A merchant or wholesale dealer buys and sells in large quantities, and his stocks may be reduced to a low level after large sales or raised to a high level after large purchases. A retail dealer's sales, it is true, are in small quantities and more or less continuous, but his purchases are more considerable, so that his stocks also are subject to discontinuities.

A working capital may be conveniently financed by temporary borrowing. Goods awaiting sale in the hands of a trader with an assured position in the market are good security for a short-term debt, and the trader is therefore in a position to supplement his own resources by obtaining temporary advances (in the form of bank loans or overdrafts or the discounting of bills of exchange) whenever it is convenient for him to extend his working capital. His own resources provide a margin between his indebtedness and the value (inevitably subject to fluctuations) of the goods he holds. And he can expand his temporary indebtedness to several times this margin if a favourable opportunity of extending his transactions occurs.

The scale of the wholesale dealer's operations therefore is almost exclusively determined by selling power. The limit imposed by the rate of growth of his capital resources is so elastic as hardly to restrain him at all. He makes his profit on the sales financed by borrowed money as well as on those financed from his own resources, and is in a position to accumulate additional capital of his own out of an income thus enlarged.

The retail dealer is not quite so favourably placed. His sales require a certain amount of fixed capital in the form of a shop, and he may employ a staff representing a substantial overhead expense. Nevertheless he can cope with a very considerable expansion of sales beyond what is normal for his establishment, and, like the wholesale dealer, can enlarge his working capital by temporary borrowing.

The response of the producer to the opportunities of increased selling power is more restricted. His fixed capital is designed for a certain output, and cannot maintain an output in excess of this capacity except for short periods and at additional cost. When he starts his enterprise and instals his capital, he has regard to his prospective selling power, and, if his forecast is correct, the enterprise is fully employed, and its output is successfully sold. If he finds that he can sell more, he can only provide an increased output by extending the capacity of the enterprise, and that will mean installing more capital and engaging more labour. For him therefore, much more than for the dealer, the growth of selling power is governed by the growth of capital equipment. But even for the producer it is still true that the opportunity for growth is offered by the expansion of selling power.

The services rendered under the description of selling power are vital to the economic system. It is a great mistake to suppose that dealers or 'middlemen' are unnecessary parasites living on their exactions from industry and from consumers.

Selling power is founded on the ascertainment of the needs which products are to meet. It is the meeting of a need that constitutes a thing a 'product' at all. Things which are not needed are not

products in the economic sense, however great the skill and hard work devoted to making them may have been.

It is the function of the profit-making trader to foresee needs, and so to direct production as to supply them. Producers, wholesale dealers and retail dealers all take their share in this responsibility. He who promotes a productive enterprise aims at producing something that will be in demand. When he instals plant which is to last for years, and which he hopes to maintain and renew indefinitely, the indispensable condition on which he counts is that there will be a continuing demand for the product.

Orders are given to producers by the dealers in goods, and the dealer's order is defined by a specification. Specifications have to be limited to the things producers are equipped to make. The limits, however, are not absolutely rigid; there is a certain adaptability in a productive enterprise. Not only can products be varied, but producers can be found to make any new products which are technically possible.

Thus producers and dealers between them take command of economic activity and give it direction. Not only do they adapt production to meet consumers' needs, but they bring to the consumers' notice the opportunities thus afforded for meeting their needs.

4. It is the retailer who is in direct contact with the consumers. On that direct contact his selling power depends. He places stocks of goods within their reach, and offers them for their inspection. He employs his own expert knowledge in ordering, specifying and selecting the goods he buys, and in advising customers what things will best meet a given need, and what are the qualities and uses of anything offered for sale. These are services essential to the efficient satisfaction of demand, and if their being well and faithfully rendered is the means of attaining an enlarged selling power, the resulting reward in the form of an enlarged income from profits, even if it be out of proportion to the other rewards offered by the competitive system, will at any rate make a powerful contribution towards the ideal of maximising satisfactions.

If consumers were wise, discriminating and careful, they would so confer their custom as to get the best service for themselves, and to favour the retailers who give it. But they have to rely in their selection on the method of trial and error, and for the most part they are neither competent to apply any but very crude tests, nor willing to give the time and trouble required for a well-founded discrimination.[1] There are people of epicurean outlook and discerning tastes, with money to spend, for whom a limited circle of skilled retail dealers will specialise in products of high quality and price. But the ordinary shopkeeper and his customers do not aspire to anything of the kind. The customers

[1] See *The Economic Problem*, chapter xviii.

are guided mainly by habit and convenience. Convenience is largely a matter of locality, and limits an individual's choice to a very small number of sellers of any one product. Habit and convenience both produce inertia, an inertia little disturbed by any initiative on the part of the customers. If it is to be disturbed, it must be by the active intervention of the traders themselves.

Retail dealers compete in the pushing of sales, partly by salesmanship, partly by advertisement and display. And this competition extends to the wholesale dealers and manufacturers who supply them with consumable goods. The competition is not merely among those who supply the same product. The suppliers of one product compete with the suppliers of others to exploit the purchasing power of the consumers, each group seeking to divert more of it to their own product. This pushing of sales appeals above all to the susceptibility of human nature to *suggestion*. That is indeed no more than another aspect of the consumers' want of initiative. One who makes a choice can only choose among the things he thinks of. To thinking of everything there is no royal road. Fertility of imagination is the precious possession of poets and artists. The power of calling into the mind a wide range of possibilities is a rare endowment of the practical mind. Theoretically, whoever aspires to choose the wisest course at any practical juncture must review all the alternatives, and must overlook none. In practical life that is impossible, but those in responsible positions do what they can to ensure that the most important alternatives are fully explored. That is an essential condition of successful administration, or of what in military operations is called staff work.

The ordinary man, called upon to decide what he will buy, has no staff work at his disposal beyond his own roving consciousness. Advertisement and the trader's push take the place of staff work. The trader endeavours by suggestion to fill the blank spaces in the consumer's mind with his own products. And it is among the images so thrust upon him that the consumer's choice is mainly exercised, among these, that is, along with those derived from his own past experience and from his neighbours' possessions and habits.

The principle of trial and error gradually sifts out the products people are best satisfied with, and discards the rest, but the principle is only applied to things that people do try. A trader aspiring to obtain a trial for his product must have recourse to pushing and publicity and to the magic of suggestion.

The producers and wholesale dealers have to push their sales with the retail dealers. The retail dealers themselves reflect in some degree the deficiencies of the consumers. They have not an unlimited fertility of mind, and their choice of things that they will buy in the hope of selling is confined to the things which manufacturers can produce.

There is undoubtedly a powerful inducement to offer novelties which will attract people's attention, and they may be originated either by dealers who put forward new specifications or by manufacturers themselves proposing them or putting them on the market. Traders therefore are by no means subject to the same degree of inertia as consumers. But in what they introduce to the market they will be guided by considerations of what can be made attractive to the consumers.

5. Competitivism conceives competition primarily as a device for determining price. But in practice price-cutting is an expedient only resorted to exceptionally. Sometimes a shrinkage of demand as a whole necessitates a reduction of prices, and there may very likely be acute competition in successive steps of price-cutting before the market regains stability at a lower level. But apart from that contingency, each trader in the market knows that, if he starts price-cutting, his competitors will immediately have to do the same; all will suffer the same loss, and none will gain at the expense of the others. All tend therefore to lapse into a state of tacit accord to maintain prices unchanged, unless a change of conditions makes the profit either inadequate for themselves or unduly attractive to potential competitors. It is the potential competitors that set the upper limit. An established trader who extends his productive capacity is playing the part of a new competitor in respect of his additional output. The effect of the tacit accord will be that he will in general only do so when he anticipates a demand for the additional output at a price which yields him a normal profit. The tacit accord operates even when the market in which the product is to be sold is fluid and sensitive. In such a market speculation may be the principal source of profit, yet there is a distinction between a speculative reduction of price and a price-cutting operation. The former is a short-period transaction taking advantage of anticipated movements in supply or in demand; the latter would aim at more or less permanently supplanting competitors.

A similar tendency to a tacit accord appears in advertising and the pushing of sales; each trader has to act up to the standard set by his competitors, and, if any one of them proceeds to do more, the only result is likely to be to set a higher standard for the rest. All will be involved in more cost and more effort, and none will gain.

The tacit accord is not a matter of hints or nods or winks; it is a recognition of the conditions imposed by facts, as when neither of two card-players is willing to lead a suit, or when neither of two armies can attack without disadvantage.

A tacit accord in regard to price-cutting or to outlays on pushing and publicity is not essential to profit-making. In its absence there may on occasion be a heavy inroad upon profits, which, if it is accompanied by an excessive extension of capacity, may last a long time. But the result is to make the profit margin unattractive to new-comers, and

sooner or later the situation will remedy itself either by demand growing up to capacity or by surplus capacity being abandoned.

If the wholesale dealer is needed as an intermediary between the manufacturer and the retail dealer, that is because the retail dealer may be supplied with a product by any of several manufacturers, and the manufacturer supplies several retail dealers. When a number of retail dealers buy from a wholesale dealer, the wholesale dealer can order goods from those manufacturers who, being conveniently situated and equipped to provide what is required, have productive capacity free and quote favourable prices.

Where that organisation exists, the selling power of the wholesale dealer depends on his business connexions with retailers, and that of the manufacturer on his business connexions with wholesale dealers. All concerned aim at attracting the consumer, and, if one trader is to persuade another to buy, he must show that his product will do so. Traders' dealings with one another are not so greatly dependent on convenience and habit as consumers' dealings with retailers. Nevertheless convenience and habit do play a great part even among them. A trader is likely to go on dealing with those whom he has dealt with in the past, and whose idiosyncrasies and requirements he knows.

The theory of competitivism, which teaches that the real merits of the product and of the services rendered are the foundation of selling power, has much truth in it. But among businesses of equal merit very great inequalities develop. Skill, knack and energy in pushing sales, combined with good luck, bring a disproportionate rate of growth to some. And even the attractiveness of the product consists largely in exploiting the weaknesses of consumers and offering superficial merits.

The past half-century has seen a change in the organisation of selling. Modern facilities of communication, combined with the progressive concentration of industry in large-scale concerns, have led to the extrusion of the wholesale dealer from certain sections of trade. A manufacturer whose output is so considerable that he looks for sales throughout a wide area, perhaps the entire community, is in a position to be his own wholesale dealer. His brand of product is made known to the retailers and to the consumers themselves by a distinctive mark or trade name, and comes to be regarded as a separate product. Customers ask for it by name, and retailers have to stock it if they are to satisfy them. The retailer who wants to replenish his stock needs no wholesaler as an intermediary, for there is only one source of supply.

The manufacturer of a branded product acquires something approaching to a monopoly, though his sales remain exposed to the competition of rival brands of the same product. When, as sometimes happens, all the more important competitors are amalgamated into

a single concern, which sells all the different brands, the monopoly becomes practically complete; new-comers would have little hope of getting any of the business. In the absence of potential competition, the combined concern can impose monopoly prices.

To competitivism monopoly is the black beast. The established exceptions to free competition are in local monopolies of transport or public utility services, where public regulation is recognised to be essential to prevent extortionate prices being charged. But if industries that start with none of the special conditions of local monopolies are liable to develop into monopolies by the expansion and amalgamation of selling power, is not the very citadel of competitivism threatened?

The threat is not so serious as at first sight appears. Monopolies of this character do not exact extortionate prices. Indeed their prices are quite likely to be actually *lower* than under the competition of numerous concerns of moderate size. For these latter will all look for a sufficient profit margin to yield the trader on a moderate scale an adequate income, and prices will be settled by tacit accord at the level which will secure this end. The single big concern is really freer to test the market for the price reductions which will yield expanding sales. And the price at which it eventually finds demand no longer elastic enough to make further reductions profitable may very possibly be lower than it would have been under the competition of many ostensibly independent traders.

That may not always be so. But the big concern with a monopoly of selling power, which attempts to enforce a scarcity price by restriction of supplies, remains exposed to the potential competition of new-comers, who can bring additional supplies, and gain selling power by price-cutting, and yet still obtain remunerative prices. The expansive policy, when it has reached the limit beyond which price reductions will evoke little additional demand, is firmly founded; for the new-comer cannot easily gain a footing by price-cutting. The tendency to monopoly is thus not so great a departure from the principles of competitivism as appears at first sight.

6. Profit-making is closely associated with the possession of capital. The earlier classical economists, Adam Smith, Ricardo and their followers, regarded profit as the remuneration of capital. That is a misconception. The remuneration of capital is *interest*, and interest and profit must be clearly distinguished. Interest is paid for a loan, when the lender is entirely dissociated from any responsibility for carrying on the enterprise in which the proceeds of the loan are employed. The trader's own capital must be deemed to earn interest at the market rate, for, if he did not use it in his own business, he could lend it. The interest he has to forgo is part of his costs.

Profit is the excess of proceeds of sale over costs, and the costs to

be deducted include interest on all the capital employed. Costs must also include compensation for the risk of loss. Anyone who places capital in an enterprise, whether he is in the position of a proprietor, partner or shareholder, or in that of a lender, runs the risk of loss in case the enterprise is a failure. The yield of the capital must provide this compensation in addition to mere interest; the excess is a kind of insurance premium against the risk of loss.

Profit is sometimes explained away as composed of nothing but compensation for risk. The investment market offers fixed interest securities and shares for sale in competition with one another. The former yield interest; the latter yield dividends, which are a participation in the profits of business, and vary with them. Competition equalises the attractiveness of the two classes to the investor, and to the shareholder, who does not in practice take any significant part in the management of the concern of which he is part owner, the additional yield offered by shares is merely remuneration for greater risk attaching to his investment. But the purchaser of shares is paying the price of capitalised profit or goodwill. In so far as the profits of the business exceed interest and compensation for risk on the capital actually put into it, the price allows for the excess in a premium over the par value of the shares. The original promoters of the enterprise, if they retain their shares, enjoy this profit in the form of income, or, if they sell them, take it out in the form of capital appreciation. If the enterprise is successful, and raises fresh capital from time to time to extend its capacity and take advantage of growing selling power, new shares may be issued at a premium, giving the existing shareholders an advantage in the division of the future enlarged profit.

It is sometimes argued that if an average were taken of the successful and unsuccessful enterprises, the yield disclosed would exceed pure interest by so moderate a margin that it would be no more than reasonable compensation for risk. That might be so. It would mean that the trader embarking on an enterprise had, in average conditions, no prospect of any remuneration for his own services at all. But the motive for enterprise consists not in the true prospect of profit but in the expectation. So long as risk enters into the matter, it is *possible* that the traders' expectations will, on the average, all come to naught.

But there is in reality no statistical foundation for such a view. Estimates of average yield to shareholders derived from the returns of companies must, no doubt, be corrected for the failures which have dropped out,[1] and the margin in excess of pure interest is thereby diminished. But, on the other hand, many companies start by buying

[1] The correction does not have to cover all the lost capital, for much of it is already recorded in trading losses, which would be allowed for in statistics of company returns as negative profits.

a going concern at a price which already includes an element of capitalised profit. Nor are public companies a perfect sample of the whole body of profit-makers. They are formed predominantly from concerns employing relatively large amounts of fixed capital, and do not include an adequate proportion of the lightly capitalised manufacturers and dealers.

Risk is an important element in the theory of profit, but the idea of a premium of insurance against a gambler's losses is much too simple. The risk-bearing which economists recognise to be a necessary economic service does not consist merely in undertaking a gambler's hazard. Rather it consists in applying special knowledge and skill to *reducing* risks. The trader and his backers who promote a new enterprise, and put their money into it, hope to get a big profit because they have special knowledge of the business to be carried on and of the opportunities offered for it. They encounter no competition from people without that special knowledge, to whom the prospect of profit would be so dubious as to be unattractive. And the same considerations apply, though in a lesser degree, to the purchase of shares, new or old, in existing enterprises. The people who buy them endeavour by means of inquiries and expert advice to form reliable opinions as to the prospects of profit. Many of course do buy shares on very inadequate information. But, if they are gamblers, it is in the spirit not of the roulette table but of the racecourse. Each relies on some morsel of special knowledge to do better than the market in measuring the odds. And, as the enthusiast of the turf assumes that owners and trainers will not enter horses for a race unless they believe them to have some degree of fitness for it, so the speculator in shares takes the considered opinion of the market as to their value to be a reasonable starting point when he acts on information which he hopes will modify the market's views in the near future.

There remains a residue of pure hazard that no amount of special knowledge and technical qualifications can eliminate. Everyone who puts money into an enterprise must estimate for himself the additional yield that will compensate him for this risk. The compensation is part of the cost of capital along with interest, depreciation and maintenance of plant; it is not part of profit.

There have been attempts to arrive at an explanation of profit from the theory of 'imperfect competition.' According to that theory the profit-making trader, even when he is not a monopolist, has to take account of the effect of *his own sales* on the price which the market will yield him. He will push his sales to the limit at which the sacrifice of price entailed by any further extension would eat up the margin of the proceeds of the additional sales over costs. At the limit, therefore, there will be an excess of price over costs.

But there can be no certainty that the excess will be such as a

normal profit requires. Indeed the excess is over prime costs and may not be sufficient to meet overhead expenses.

And the theory presupposes that the trader will base his plans on a potential price-cutting and sale-pushing competition which can be independent of his competitors' action. Competition would have to be very imperfect indeed for that hypothesis to be realised. Even if his product is so far individual and non-competitive that it can be sold at prices perceptibly diverging from theirs, with only limited reactions on their sales, still they are not likely to ignore his proceedings. He must expect them to meet price-cutting with price-cutting and sale-pushing with sale-pushing.

The theory of imperfect competition has its importance, but it is not in itself a theory of profit.

To say that success as a profit-maker is to be attained only by working on the minds of consumers and taking advantage of their weaknesses would be a cynical exaggeration. The average consumer may not be very discerning in regard to the quality of the things offered him, but the method of trial and error still does something to select the better and reject the worse. Competition exacts a certain standard of quality from all traders as a condition of maintaining their selling power. The trader who produces a better quality gets some advantage in pleasing the more discriminating consumers, and he who organises and administers his business more efficiently gets the advantage of lower costs.

Nevertheless among the mass of traders whose products pass muster, selling power depends largely on activities and faculties which have little to do with utility or welfare, largely also on mere luck.

Selling power, as we have seen, must be fertilised by adequate capital. But profit is itself the principal source of accumulation of savings. It provides opportunities of easy money-making. The successful trader receives an income largely in excess of mere interest on his existing capital, and one which, being dependent on his own activity and also fluctuating according to the conditions of his market, is precarious. He has the means and motive for saving, in contrast both with the rich rentier whose income is derived from interest and who need not add to his capital in order to ensure its continuance undiminished, and with the salary-earner whose income depends on his employment, but is less fluctuating and is more limited in amount.

In many cases the growth of a trader's selling power and the accumulation of capital resources out of his own profits keep pace together; he is progressively enriched without raising capital from others. Or his accumulation may outstrip his selling power, and a part of his savings be invested outside his business. Even the trader who has to raise outside capital and share his responsibility with partners or shareholders, will probably prefer to invest elsewhere a part of the

profit he draws out, in order that his fortune may not be wholly involved in a single venture.

7. Profit-making, when thus directed to accumulation, is what is commonly called money-making. It is the principal cause of economic inequality. It is not the sole cause, but even where other causes are more directly at work, profit-making is usually a contributory condition. People with special professional skill in technology, organisation, law and other pursuits attain big incomes from salaries or fees because they render services to profit-makers who are concerned with large-scale pecuniary operations. The big incomes of the profit-makers react here on the market for such services, which is a part of the labour market itself.

An important rival cause of inequality is the private ownership of land and therefore of land values. By ' land values ' are meant natural advantages which accrue to economic activity in a particular place, but which are not imputable to capital outlay applied to the place. They include the productivity of the soil and minerals, and also the advantages of situation. Though we define land values to be ' natural ' advantages and not to be imputable to capital outlay, these phrases must be taken in a special and rather narrow sense. For advantages of situation are not created by unaided nature, and do depend on the capital outlay applied to the development, communications and transport facilities of *the surrounding community*. That applies to soil and minerals, the value of which depends, among other things, on access to markets. But it applies still more to urban sites. Great cities are primarily marketing centres. Convenience in marketing calls for concentration of transactions, and the building sites which confer this convenience command very high prices, especially in centres which combine finance with commerce. Finance, which turns over money, is as much a source of profit as commerce, which turns over goods. Around a great commercial and financial centre there grow up luxurious residential quarters with every facility for spending the swollen incomes of the money-makers. These give rise to a secondary crop of high-valued sites, especially, for instance, in the best shopping centres.

A centre of government may form a considerable city, with a numerous middle-class population. But the great capital cities combine the functions of a centre of government and a centre of marketing. There are also great industrial towns. But industry taken by itself is never the source of such high site values as commerce and finance. Producers are profit-makers as much as dealers, but they do not need to be assembled together at a central point. Dealers, whether in goods or in money, have to carry on business in close proximity to one another. The high rents which afford a gigantic income to a ground landlord are a very slight charge to the traders who pay them for the indispensable advantage of convenient access to their market.

Big incomes from property, however, are not all of this type. In a community where private ownership of land is established and continues uninterrupted from generation to generation and from century to century, the economic value of any one landed estate becomes very much a matter of chance. Land, once apportioned under primitive conditions, remains attached to land-owning families or becomes the subject of purchase and sale. At the first apportionment its ultimate economic uses are not foreseen. As the community grows in population and wealth, holdings which have previously yielded no more than a modest living to the owners are developed for residential and industrial purposes. So developed, an area of a few acres may become the source of a huge fortune, even when it contains no important centre of profit-making and the tenants who occupy it are themselves of no more than average means.

The creation of great fortunes from land-owning is facilitated by the leasehold system, which enables a land-owner to procure the activities of capitalists to build on his land and occupy it for a period of, say, 60 or 100 years. During the lease the capitalist gets the benefit of his capital subject to the payment of a ground rent, but at the end the whole property reverts to the landlord, with a value derived not only from the existing structures, which may be obsolete or dilapidated, but from the established position of the locality for residence or business. The land-owning family is thus enabled to develop its land in the course of generations without having to find any capital resources of its own, and without even having to plan the development, except to the extent of choosing efficient and enterprising capitalists among those who offer to take leases.

If the leasehold system (apart from short tenancies) is precluded by law or custom, the responsibility for planning development and for raising capital rests with the owner; if he is not himself competent to undertake the enterprise, he can only obtain the enhanced value of his land by selling it. The development of property thus comes into the hands of landowners who are able and willing to play the part of traders and promoters, and it is they and their successors who get the advantage of increments of land values in addition to the profits of enterprise and interest on their capital.

Land-ownership is also, even in its origin and apart from the growth of land values, a cause of inequality, when the original apportionment creates big estates. That occurred when feudalism distributed conquered territory among leaders, and gave each the rights not only of a possessor of the land but in some respects of a ruler over the tenants and serfs. It likewise occurs when big ranches, plantations, mining concessions and similar rights are allotted by the sovereign power responsible for developing a new colony. To the whole subject of enterprises which exploit the resources of new or undeveloped countries,

and which derive their yield from land values as well as profit-making, we shall have to turn at a later stage (see Chapter IX, pp. 146–9).

8. Profit-making depends on the control of capital, and large-scale enterprises do not necessarily mean correspondingly large incomes from profits, since the capital may be contributed by numerous small shareholders and the profits divided among them. Even the investor who has bought shares in the market and paid a price which includes some capitalised goodwill, provided his expectations are not disappointed, may be regarded as receiving something on account of profit in addition to interest and compensation for risk on his outlay, so long as his selection of the shares was guided by special knowledge or skilled advice. And there are profit-making occupations in which under certain conditions small enterprises predominate, especially agriculture and retailing. Indeed it is characteristic of profit-making that it gives rise to wide inequalities of income among the profit-makers themselves. And from the earliest times, even when industry was in a primitive state and the division of labour was very limited, the rich merchant was a conspicuous figure.

Progress in transport and communications and in the instruments of production has permitted an immense development of the division of labour in modern times. The subdivision and specialisation of economic processes have multiplied the profit-yielding transactions. In spite of the facilities for the subdivision of shareholding, big profit-making incomes are more than ever prevalent. *New* enterprises are not usually provided with capital by a public issue of shares. In the nineteenth century they used to be founded by individuals or by small partnerships. Nowadays they are more usually founded in company form, but by a small number of participators constituting a private company. The extension of a successful enterprise is financed as far as possible by the reinvestment of its own undistributed profits. When a public issue of capital becomes necessary, and the concern is reconstructed as a public company, the original shareholders are in a position to retain for themselves the full benefit of the profit-making power of their own shares, either by issuing additional shares to themselves as the price of the business taken over by what is in form a new company, or, if the company retains its identity, by issuing the new shares at a premium.

The selling power of any concern necessarily depends on the individuals by whom it is actually carried on. The investor who exercises a judicious power of selection in acquiring shares is relying mainly on them. Modern business has engendered a race of specialists who combine the technical knowledge, the financial skill and the organising capacity required for promoting and carrying on an enterprise with the push and cunning that make for selling power. It is these who take the lead in profit-making. A trader equipped with the necessary

qualifications, once he gains a footing, will soon add to them the command of resources, and, subject to possible vicissitudes of fortune, is likely to become a rich man and an industrial, financial or commercial magnate. The tribe includes many gradations. And individuals seriously deficient in some part of the requisite qualities may yet carry on profit-making concerns with success all their lives. Luck often has much to do with it. A trader with very limited qualifications may strike demand, as a land-owner may strike minerals, and enter upon an easily acquired prosperity that he neither foresaw nor to any material extent brought about. But the most important share of profit-making devolves upon the inner circle of fully qualified profit-makers, who of set purpose seek out selling opportunities, and who are both competent to exploit them and able to command the requisite financial resources.

CHAPTER III

DEMOCRACY AND INEQUALITY

1. THE principle of democracy is to place the control of Government in the hands of the whole body of people or in so considerable a part of them as to guard against the abuse of power or privilege either by an autocrat or by any limited class.

The democratic movement of modern times may be said to start with the Reformation. The medieval Church was responsible for some of the principal functions of Government outside the strict sphere of religion. Not only were education, learning and the relief of the poor entrusted to it, but much also of the law relating to the family, such as marriage and inheritance. And the legislative and administrative discretion of the feudal organs of Government were narrowly limited by customary and moral principles for the interpretation of which people would turn to the ecclesiastical authorities. Medieval lords and kings were quite accustomed to being subjected to disciplinary measures by the Church. They were, it is true, often recalcitrant, but rather by way of relying on a rebellious use of force to get their own way than of questioning the authority of the Church in principle.

When the abuses that had infected the Church in the fifteenth century brought the medieval system into discredit, the resulting reform movements were political as well as religious and moral. Once people claimed the right to decide their religious ideas and observances for themselves, the restraints by which the sphere of Government had been delimited were swept away. The sovereign power assumed a new freedom and new responsibilities. But Government cannot dispense with guiding principles. If the governing authorities were left to devise the principles for themselves, the way was open to every sort of abuse of power.

The medieval organs of Government survived. Feudalism had delegated authority to privileged land-owners, great and small. The subdivision of power, based on tradition, custom and inheritance, was ill adapted to cope with the broad questions of policy with which Europe was confronted from the sixteenth century onwards. The need for political leadership brought about an evolution of monarchy from a feudal overlordship into an autocracy tempered by an aristocratic governing class.

But medieval society had produced the germs of another political system in the shape of representative government. In England a representative parliament, in association with the Puritanism of the seventeenth century, showed how the desires of a whole nation might be brought to bear on policy.

Apart from the fleeting experiments of the Commonwealth, it was not till the establishment of American independence that representative government came to be accepted as the instrument of democracy. Hard on American independence followed the French Revolution, and in the nineteenth century the spread in Europe of parliamentary government on the English model, with electoral systems first cautiously extended to the middle class and then approximating more and more closely to manhood suffrage.

The representative principle was applied both to the legislature and to the executive. In the United States the elective principle was applied directly to the head of the executive in the person of the President. In England and France and other European democracies the executive Government was appointed by the king or president as head of the State, but was made responsible to an elected parliament through the parliamentary control over the raising and spending of money. In countries such as Germany and Austria, where there were elective parliaments but the executive Governments were not made fully responsible to them, democratic control was incomplete. But, even without a responsible executive, an elective legislature was an important concession to the democratic principle.

Feudalism in the strict sense had faded away in England before parliamentary government was evolved. Villeinage or serfdom hardly survived into the sixteenth century, feudal dues were abolished in the seventeenth. The feudal jurisdiction of the lord had been superseded by the power of the central executive and legislature. Yet the land-owners were still a governing class. The vagaries of a franchise which had never been systematised since the fifteenth century put a great part of the constituencies which elected the House of Commons under the predominant influence of local land-owners. And it was the land-owning class which provided candidates both for election to Parliament and for political office, and they retained an important local jurisdiction as justices of the peace. In the eighteenth century merchants and bankers were beginning to gain a footing in politics, but the power of land had not been appreciably encroached on.

Up to the period of the French Revolution English political controversy had been mainly concerned with the relative powers of King and Parliament, with the securities for the freedom of the individual and with religious issues. Economic policy, prominent enough in legislation and administration, had not usually raised great political issues.

In France the evolution of parliamentary government had been arrested for nearly two centuries. Feudalism as a living force had been superseded by a centralised monarchy, an autocracy limited only by the survival of empty legal forms and aristocratic privileges. But the social and economic life of the country was encumbered with

onerous feudal dues and services. The serfs of the middle ages had been transformed into peasants, but many of the obligations of serfdom remained. Disastrous wars had reduced French finances to chaos, and yet it was impossible to induce the aristocracy and clergy to accept any derogation from their exemptions from taxation.

Emancipation came with explosive force, and the remnants of feudalism were swept away. The way was opened to government according to reason.

The Revolution failed to find an effective organ of democratic government. Its constitutional experiments soon degenerated into the Napoleonic dictatorship. The abolition of feudalism not only in France but in western Europe survived.

The July Revolution that put Louis Philippe on the throne in 1830 and the English Reform Act of 1832 initiated a period of middle-class democracy. It was a long way from the conception of government by the whole body of the people, but it did revive the idea of government according to reason. The utilitarians supplied a political philosophy. At the outset government according to reason had been a negative ideal; it had meant the elimination of privileges and obligations which were arbitrary and not according to reason. And the utilitarian doctrine, though it adopted the positive end of happiness, the greatest happiness of the greatest number, remained negative. Happiness was to be attained through freedom, and government could do no more for it than interpose just such amount of limitation of each man's freedom as would secure the freedom of his neighbours.

The competitive system, the economic policy of let-do, was an integral part of this doctrine. In practice indeed it was by no means consistently applied. While a poor law that associated the relief of destitution with severely deterrent conditions, and a sweeping reform of indirect taxation on a basis of free trade were the natural fruits of let-do, there came along with them the beginning of the Factory Acts. But on the whole the policy of the middle-class democracy was one of individualism.

2. The tenure of middle-class democracy in the middle of the nineteenth century was by no means secure. In England it was threatened by the Chartists, who advocated a logically complete system of representative government, embodying manhood suffrage and safeguarded against the predominance of wealth by the payment of members of Parliament and the abolition of the property qualification. And the revolutionary movements of 1848 in Europe portended a new development of democracy; its advocates were looking beyond the mere establishment of democratic institutions, and were considering what specific uses the people were to make of their political power, when they obtained it, to improve their own condition.

The first French Revolution had brought disillusionment in its day.

It is a remarkable fact that its representative assemblies were all elected on the very conservative basis adopted in the constitution of 1791. The franchise, reaching everyone who paid direct taxes, was indeed fairly wide, but the system of election was indirect. The mass of voters selected a smaller number of electors with a substantial property or income qualification, and it was these latter who actually elected the deputies. The Convention elected in 1792, which condemned the King to death and established the Committee of Public Safety, was formed on the same system. The Constitution of 1793, which the Jacobins adopted when they turned out the Girondists or moderates, was based on manhood suffrage, but it never came into operation; it was in abeyance during the Reign of Terror, and the Constitution of 1795, which superseded it, retained much the same electoral system as that of 1791.

The Reign of Terror was a war-time usurpation. The decrees of the Committee of Public Safety were concerned with defending the Republic against enemies inside France as well as outside, rather than with establishing permanent institutions for the rule of the Sovereign People. When the pressure was relaxed in 1795, the dictatorship of the Jacobin Party was ended, and there emerged a middle-class Republic. The extinction of feudal privileges once completed, the Republic seemed to be committed to the rights of property and the rule of let-do. But there were still adherents of the Revolution who had looked forward to using democracy as an instrument for making more fundamental changes. Babeuf, whose name appears in history as the pioneer of revolutionary communism, advocated *égalité de fait*, effective equality. In his days of obscurity he had attacked the Constitution of 1791 because the Rights of Man, which it recited, consecrated the rights of property, the right of everyone to dispose at his will of his goods, his income, his capital, his industry. Property itself was an illegitimate privilege.

The Conspiracy of the Equals, the leadership of which in 1796 brought Babeuf fame and the guillotine, aimed at a community of goods and a community of labour. The programme of Babeuf was to place all individual wealth under the control of the Republic; to put all able-bodied citizens to work in rational co-operation; to concentrate in public control the products of the land and industry and to distribute the enjoyment of them equally; to destroy at their source private property and commerce, and to substitute a wise distribution entrusted to the public authorities, and to organise a common education.[1]

In the France of 1796 industrialism had not yet bred its swarms of wage-paid workpeople, and attacks on property were not likely to appeal to the peasants who were the main body of the community.

[1] *Babeuf et la Conjuration des Égaux*, by Gérard Walter, p. 188.

Babeuf's conspiracy had to seek support from the remnant of the Jacobin party, and to dilute its programme of equal subsistence and equal education with the advocacy of the Constitution of 1793. Democracy by itself, however thorough, was likely to be sterile.

Babeuf was by no means content with an incitement to confiscation and spoliation. He recognised that, if the State was to attain effective equality by a redistribution of wealth, it must be prepared to assume the responsibilities of the property owners in organising the productive resources of the community. In the half-century that intervened between the conspiracy of 1796 and the revolutionary movements of 1848 thought on the subject had made progress both in France and elsewhere. And industrialism had spread from England to western Europe and was growing rapidly.

But it was still far from having made sufficient progress in France to enable the industrial wage-earners to exercise preponderant power even with the widest franchise. The Revolution of that year started with a violently communist bias, but the first elections immediately redressed the balance. Manhood suffrage had merely diluted the middle-class democracy with the peasant voters. When the ephemeral Second Republic was succeeded, after the interval of the Bonapartist reaction and the war of 1870, by the Third, French democracy retained its conservative character.

3. The revolutionary movements of 1848 came at the very moment when the Communist Manifesto of Marx and Engels had just appeared. The Manifesto formulated the doctrine that was to inspire communist movements up to the present day. It preached a class war arising out of the decay of feudalism. The old governing class, the feudal lords who lived on the land, had been successfully assailed by those who enjoyed the freedom of the towns. The gentry were displaced from power by the burgessry. The burgessry, the Manifesto contended, had developed into a class of profit-makers who lived by exploiting the new working class or proletariat. Industrialism had given the profit-makers their opportunity. 'The worker has become a mere appendage to a machine; a person from whom nothing is expected but the simplest, the most monotonous, and the most easily learned manipulations. The cost of production of a worker therefore amounts to little more than the cost of the subsistence he needs for his upkeep and for the propagation of his race. Now the price of a commodity, labour not excepted, is equal to the cost of producing it.'

Here is the theory of profit afterwards elaborated by Marx in *Das Kapital*. The value of a product is equal to its labour cost. He who buys labour and sells the product only pays the labour cost of the labour. The subsistence theory of wages made the labour cost of labour something much less than the labour itself, and the surplus would go to the profit-making employer.

The wage-earner cannot accumulate property, for all he can appropriate 'suffices merely to support his bare existence and to reproduce his kind.' It is the profit-makers who accumulate wealth; labour creates capital in their hands.

In its origin the term *proletariat* was applied to those who, having no property, could serve the State only by producing offspring or *proles*. The proletariat of the Manifesto consists of the workmen who *produce* wealth but *accumulate* nothing but offspring.

But the unequal distribution of wealth was not the only target of the Manifesto's attack. The profit-makers gained not only wealth but power. They were superseding the land-owners as the ruling class. And the industrial capitalist had become the autocrat of masses of workers crowded together in the factory and organised in military discipline, in daily and hourly subjection to the machine, to the foreman and above all to the individual manufacturer. 'The more frankly this despotism avows gain to be its object, the more mean, odious and galling does it become.'

The Manifesto's diatribes led up to a programme which was to include the expropriation of landed property, a vigorously graduated income tax, abolition of the right of inheritance, centralisation of credit and banking and of the means of transport in the hands of the State, increase of national factories and means of production, universal and equal obligation to work, public and free education of children.

'When, in the course of social evolution, class distinctions have disappeared, and when all the work of production has been concentrated into the hands of associated producers, public authority will lose its political character.' The class war will be over.

The tactics of the class war were not to be confined to revolutionary violence. Given the preponderant numbers of the proletariat, democratic institutions themselves might smooth the path. But the Manifesto looked rather towards the combination of labour, and the workmen's power of calling strikes, and it was unlikely that the governing class of profit-makers would eventually surrender to anything but sheer force.

The Manifesto's attack was directed against the abuses of profit-making, and its theory of profit-making was founded on the two principles of the labour theory of value and the subsistence theory of wages. It is plausible enough, as a first approach, to say that the value of a thing is its labour cost; people put their labour into making it because the product is worth the labour; if it were not, they need not make it. Much of the science of economics indeed consists in the investigation of *other* elements of cost, interest, risk and rent, which must equally be reflected in value. There must be some inducement to employ capital in industry. There must be some means of balancing the greater or less advantages of different producers in regard to local

situation and the supply of natural products. But the labour theory of value is not really essential to the argument. Interest and rent can both be expressed in terms of the labour-saving capacity of the capital and the land values for which they are paid.

There remains therefore the subsistence theory of wages. That theory, as enunciated by Ricardo and the classical economists, meant that the working population always tended so to multiply in numbers as to depress wages to the subsistence level. Marx regarded it as a particular case of the labour theory of value. If people would produce anything provided its value covered its cost, they would produce labour on the same terms. Producing labour might be interpreted, as in the classical theory of the subsistence wage, to mean producing population. Or it might be taken to mean setting a given population to work. The classical version of the theory was always open to the objection that the breeding of additional population takes time, and may lag behind technological development, or that an increase in the wage-earners' income may not actually induce an increase in numbers at all.

Marx did not disavow the population theory. He even in one passage includes in his indictment of the capitalists the accusation that they actually induce the fatal increase of population by paying the workmen sufficient wages to cover the cost of growing families as well as their own subsistence.[1]

In a later section he inclines to the view that it is not the growth of population that is responsible for keeping wages down to the subsistence level, but the existence of a reserve of unemployed labour. Here he does not seem to have considered the objection that there is no obvious reason why the supply of fresh labour should not reach its limit in full employment at a stage at which wages are still above the subsistence level.

But wages may be above the subsistence level and still leave a surplus. Indeed, as we saw in the last chapter, there must be some surplus or the trader would get no remuneration at all.

The Communist Manifesto draws a distinction between big and little profit-makers. The little profit-makers, small-scale producers, retailers, small farmers and peasants, suffer almost as much as the proletariat from the oppression of the big profit-makers, and are indeed the natural allies of the proletariat in the class war. It is big business that is the enemy. The profit margin which yields an adequate income

[1] 'If these constituents' (the material constituents of new capital) 'are actually to function as capital, the capitalist class must have an additional supply of labour. . . . The mechanism of capitalist production has already provided for this emergency, inasmuch as capitalism sees to it that the working class shall reproduce itself as a class dependent on wages, but as one whose members' customary wages suffice not merely for their own maintenance, but also for their increase' (*Das Kapital*, translated by E. and C. Paul, 1930, vol. ii, p. 638.

to the little trader yields an excessive income to the big trader. There is the abuse.

Thus Marx gave an untenable theory of the surplus, but he did throw light on the nature of a surplus and on the abuses to which it might give rise. If he failed to associate the surplus with selling power, that was because he took the marketing process for granted, and assumed that people would always produce anything of which the value covered the cost. If that was so, there was no margin to provide payment for the service of selecting for production the things that would be sufficiently in demand to cover cost, and of bringing together the requisite productive factors to produce them. He found the surplus in the exploitation of labour through the subsistence theory of wages. Communists who derived their inspiration from Marx have failed to see that, if the subsistence theory were true, the ultimate effect of any revolutionary change designed to improve the resources of the proletariat would only be such an increase in numbers as would reduce *everyone* to the subsistence standard.

The Communist Manifesto traced the class war to the decay of feudalism. The war of serfs against feudal lords had made way for that of the proletariat against capitalist employers. And there is a striking parallel to be drawn between the feudal lord and the capitalist employer.

Feudalism associated land-ownership with rule. The feudal lord, as it were, *farmed* the government of his fief. In consideration of his taking this responsibility, he was given, subject to the restrictions of law, full ownership of the fief. This delegation of authority was convenient, because under medieval conditions communications were too imperfect to allow the exercise of detailed control from the centre over a wide area. The State was an organisation for war, and usually the only condition that the overlord exacted from his vassals was that each should be responsible for the organised force of his fief, and should faithfully place it at the overlord's disposal in case of need. Work on the land was necessary to the livelihood of the population, and ownership of the land carried with it a despotic authority over them, tempered only by the limitations imposed by law and custom.

The growth of trade and industry provided alternative means of living, and displaced the land-owners from their unique position. And the profit-making employer has acquired something of the authority that the land-owner has lost. His enterprise makes a contribution to the resources of the community, and he may be regarded as 'farming' it. The enterprise requires organisation, and organisation means discipline. Within the limits of this necessary discipline the employer is an autocrat. He has found the opening for his enterprise, has accumulated or procured the necessary capital equipment, engaged and organised the necessary labour, and in consideration of these services

is allowed to own the business, to exercise authority over it, and to appropriate to himself whatever surplus the proceeds of sale of the product may yield.

A productive enterprise is a public institution. Under the competitive system the responsibility for all enterprises, with strictly limited exceptions, is delegated to profit-making traders, yet upon these enterprises the economic life of the community depends. It is through them that the productive power of the population is made available to meet their needs. Thus the profit-making trader is fulfilling a public function just as much as the feudal lord, though the jurisdiction of the former is more limited than that of the latter.

4. It was not till the latter part of the nineteenth century that European democracy became established in electoral systems which enfranchised the main body of the wage-earning class. The British Electoral Reform Acts of 1867 and 1885 mark the epoch. Gradually this fundamental change made itself felt in the substitution of a more positive policy for that suppression of arbitrary privileges which had satisfied the middle-class taste for government according to reason. Democracy began to be used as an instrument for establishing effective equality. A beginning had already been made with what are now called the social services, in the establishment of universal compulsory elementary education and in the systematisation of local authorities' responsibility for sanitation, when Joseph Chamberlain, in a famous speech delivered in January 1885, argued that property owners must pay 'ransom' to the community for their possessions. Ransom was something less than confiscation, but it was quite in the spirit of the class war.

For a time the attention of the British electorate was turned to other issues, the Irish question and Imperial and foreign politics. And it was not till the introduction of old age pensions in 1908 that the policy of employing direct taxation to enlarge the social services was fairly entered upon.

On the side of taxation a beginning had been made with Harcourt's death duties in the budget of 1894. A progressive duty on estates left at death, graduated according to the total sum left, looked like a ransom in place of the communists' more thorough prohibition of inheritance.

The Lloyd George Budget of 1909 added a progressive income tax in the form of a graduated supertax on big incomes. The expansion of the social services was in full swing when the outbreak of war in 1914 brought new fiscal problems. Post-war financial burdens led to the example set by England being followed all over the world. Very heavy percentages were taken both of the larger incomes and of the larger estates passing on death. Ransom apart, heavy direct taxation was unavoidable to meet the liabilities for war debts and war pensions.

But the principle of ransom was discernible not only in the steep graduation of the direct taxes but in the continuance and enlargement of the expenditure on social services, despite the other burdens.

Where is the limit to this process? Competitivism is often defended as conforming to ineradicable tendencies in human nature. As applied by middle-class democracy, it gave the trader the unimpaired enjoyment of the whole of his profit. An income tax of 2 or 3 per cent. rising only temporarily in war time to 5 or 6, and innocent of graduation except in abatements for small incomes, detracted little from this happy exploitation. But a peace-time tax of 20 or 25 per cent., plus a supertax or surtax rising to an even higher proportion, makes the State a partner in enterprise, and, where big profit-making incomes are concerned, a very wide-mouthed partner.

Income tax and surtax, it is true, do not in themselves discriminate against the profit-maker. His income is put on the same footing as any other. The small income derived from profit enjoys abatements like that derived from any other source. The big income derived from profit pays no more than any other big income. The policy of ransom is aimed indeed at wealth as such, and not at any particular source of wealth.

But most of the big incomes are derived directly from profit, and most of the big aggregates of wealth are accumulated out of profit. If a wealthy man who is living on the interest of his capital has to pay half his income in taxation, he must content himself with a reduced standard of expenditure and more modest establishments. On the other hand, one who is employing his capital in profit-making business, and obtaining an income which, while fluctuating, averages two or three times mere interest or even more, cannot treat this income as a permanency. He is 'making money,' that is to say, accumulating a great part of his current receipts. He cannot meet his tax burden merely by reducing his standard of living, but must also retard his rate of accumulation. The effect on the profit-maker is therefore greater than on the rentier. And sometimes there are direct taxes on profits as such, though these have hitherto been of an emergency character, whether a percentage of all profits, like the German Corporation tax and the British National Defence contribution imposed in 1937, or an excess profits tax.

Even in 1930, before rearmament had begun, income tax in the United Kingdom was 5*s*. in the pound, and surtax on the highest zone of income (on the excess over £500,000 a year) was 8*s*. 3*d*. The two together were 66¼ per cent. Under war conditions the burden has been raised to 97½ per cent. on the excess over £20,000. For an income of £10,000 a year (with abatements for earned income and three children) the tax burden has risen from £3,457 to £6,757.

Tremendous as these percentages seem, they probably do not

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seriously impair the profit-making motive. 'Thou shalt not muzzle the ox that treadeth out the corn,' but the pickings that the unmuzzled ox gets out of the corn are a very inconsiderable proportion. In any lawless state of society, where bands of robbers prey upon those who produce wealth, the system of ransom is likely to grow up. The robbers find that if their exactions go beyond a certain limit they have killed the goose that lays the golden eggs. They must leave the producers some inducement to go on producing, and accordingly they commute their power of indiscriminate robbery for an agreed sum by way of ransom. How far they can go is a nice question, but they probably settle it by very rough and ready methods.

When it is a question not of robbery but of taxation, a longer and more sober view is called for. The community must leave the profit-maker not merely a sufficient motive to continue producing, but both the motive and the means to accumulate and to extend the capital equipment of industry. A large share of the saving that is made available for that purpose is performed by the profit-makers themselves in the shape of undistributed profits reinvested in their own business. Growing prosperity enables salary-earners and wage-earners to save on a not inconsiderable scale. The proletariat are no longer unable to accumulate anything but offspring. But every transfer of wealth from the profit-makers to the rest of the people is likely to be accompanied on the whole by a diminution of total saving. In itself that means a retardation of the growth of material well-being.

There are limits to the desirable rate of accumulation, and that is a topic to which we shall have to turn later on (below, pp. 280-3). What is now in point is that a too drastic application of the principle of ransom is likely to reduce accumulation below the desirable limit. It may also fail to place the accumulation which does occur in the hands of the traders who would make the most fruitful use of it. In other ways too an excessive strain on the fiscal machine produces undesirable results. The taxpayer's motive to evade the burden becomes more powerful, administrative control more searching and vexatious.

These limitations are often thrust aside as fictitious by enthusiasts advocating an 'expansionist' policy. Desirable objects such as the social services or works of development, it is contended, should not be restricted or retarded out of deference for the 'money sign.'

The money sign, it is true, signifies no more than the relation between debtor and creditor, and an aggregate of money units must not be confused with an aggregate of wealth. But that does not mean that expenditure can be expanded without limit. Money totals are like the shadows of economic quantities. The shadow is not to be confused with the substance, yet it is a faithful indicator of the magnitude of the substance. The money total does not correspond exactly with the amount of work done. Other imperfections apart, it includes

the margin of profit. But that only means that the money total exaggerates the total of work which it represents when it includes an abnormally large profit margin. That is hardly what the advocates of an expansionist policy would desire.

The work done itself is not truly measurable. Not only are there inequalities in rates of pay corresponding to no rational standards, but in particular cases work may produce results to which measurement by market value is completely inapplicable (below, pp. 208–10). Yet when an assigned portion of the available work of the community is to be directed to a certain end, that makes a definite inroad on the productive resources available for all other ends, and the money paid is a fair practical measure of the extent of the inroad.

Ransom is essentially a compromise, falling short of 'effective equality.' Whether the compromise can be elaborated so as to produce a stable system which will satisfy both democratic aspirations and the requirements of modern industry, we shall have to consider at a later stage. There is the alternative of thorough-going collectivism. Going beyond the Communist Manifesto itself, the socialists of the late nineteenth century formulated their aim as the nationalisation of the means of production, distribution and exchange. Nationalisation here does not mean merely the State ownership of capital equipment, which would be compatible with a system of leasing to traders who would pay rent and interest and continue to make profit. The principle of collectivism is that private profit is eliminated altogether, and the State becomes the sole profit-maker. The State becomes responsible for all economic enterprise, and employs salaried industrialists, managers and technicians to serve it.

That does not necessarily mean equal incomes for all. Babeuf indeed carried his equalitarian zeal so far as to argue that differences of skill and productivity among individuals were more or less fictitious. Of how many stump orators was he the precursor! 'One man is as good as another, says I. And a great deal better too, says I.' Marx on the other hand recognised grades of labour to be remunerated at higher rates than average labour. Modern socialism often adopts the formula, From each according to capacity; to each according to need. Such a complete dissociation of remuneration from skill is not a necessary corollary of collectivism, but collectivism would be a prerequisite condition of it.

Collectivism may in fact be identified with effective equality. It would release human society from the two principal causes of inequality, profit and private ownership of land values. Whatever inequality remained would be the result of deliberate policy.

5. It is a strange paradox that the cause of effective equality has become separated from that of democracy. When the Revolution of 1917 established communism in Russia, the dictatorship of the prole-

tariat was not a democracy. It became in reality, as Mr. Bertrand Russell said, a dictatorship not of the proletariat but of the Communist Party. It was the first modern experiment in totalitarian discipline.

If democracy were nothing more than an instrument for achieving effective equality, then, it might be reasoned, once effective equality was securely attained, democracy could sing *Nunc dimittis*, and seek euthanasia. The Russian communists were actuated by an intense conviction of what the results of the Revolution ought to be. The main body of the population had no very positive views to oppose to the communist urge. Except for a few, they were without any political education, and were incapable of weighing the issues put before them. The Liberal Government installed in the first stage of the Revolution was fatally discredited when it failed to extricate Russia from the war, and the communists, when they assumed power, were simply filling a vacuum. Communism once established, there could be no going back.

All government is, in a sense, government by a party. A primitive government, confined by traditional and customary limitations, has very little discretion. Its procedure is taken for granted by everyone. All are united in the pursuit of one policy, and all may be said to belong to one party. When progress brings changes, a need for adapting and modifying institutions begins to be felt. If there is a difference of opinion as to what ought to be done, parties within the one primitive party appear. That is so whatever the system of government may be. The rival parties may compete for the favour of an autocrat or of a governing class or of a democracy.

In a normally developing community the differences between parties are limited. All still belong to one comprehensive party, in that all accept the main traditional principles of government. At the same time the differences tend to be more extensive than a mere divergence of view as to some single proposed innovation. An important social or economic change is likely to require a series of interdependent innovations, and a party programme must include the whole series. The governing power, whether autocratic, oligarchic or democratic, has to choose whether to make a change, and, if the change is to be made, which of several possible series of measures is to be adopted.

So long as the fundamental presuppositions of the political system are not challenged, this choice of parties can proceed freely. All parties are contained within the one party. But when there springs up an extremist or revolutionary party, rejecting some of those presuppositions which have hitherto been taken for granted, so that its success will mean not merely a new policy but a new polity, the system of giving each party an innings, when a situation to which its measures seem appropriate arises, breaks down. Once the revolutionary party has been given its opportunity, the field is closed to the endeavours of

the other parties. Thereafter whatever parties there are must be new parties accepting the new presuppositions.

A revolutionary party thus widens the extent of disagreement among parties by assailing certain principles on which all parties were previously agreed. It does not necessarily resort to violence, or even advocate violence. The mere appearance of such a party in the field of politics may set other people reconsidering their principles, till a fundamental change in outlook is brought about, and the revolution is accomplished by consent.

But it is not easy to bring people to reconsider their principles. And fundamental principles are all the less open to attack if they have been taken for granted. If they have not been arrived at by reasoning, it is difficult to dislodge them by reasoning. Indeed how are they to be reconsidered if they have never been considered?

A body of ardent and active revolutionaries, devoted to a cause, will not willingly resign themselves to dispelling the traditional prejudices of the mass of people by gradual persuasion. And even if they do, and they succeed in winning the people over, how are they to guard against reaction and counter-revolution? Democratic institutions could allow all the gains of the revolution to be swept away in a day by a popular vote, if the old prejudices reassert themselves or discontent evokes antagonism.

The Russian revolutionaries of 1917 had to deal with a population unaccustomed to democratic institutions. They were no more than a small minority, but were sufficiently numerous to spread party representatives over the whole country, either themselves to fill office or to exercise supervision and control over every branch of public service. These party representatives were expected not merely to convey instructions from the centre, and to see that all measures were put into effect in accordance with the communist spirit, but also to be censors of opinion. It was their function to discover who in their respective localities were not sufficiently sympathetic to the regime or at any rate not sufficiently acquiescent.

Here was the instrument of tyranny in full operation. It was not new. The Roman emperors had their *delatores*. The Venetian oligarchy had its secret denunciations. Even government by a party of fanatics was not new. Cromwell's Puritans tried it. So did the Jacobins of the Terror.

Both the Puritans and the Jacobins brought to their task the same kind of devotion as the Bolsheviks. Individual members of the party in each case could be relied on to show an energy and a vigilance compared with which the humdrum loyalty of the political leaders and the paid officials of an established government would be a pale shadow. Communism has been called a new religion, and, when taken in that spirit, it possesses the cohesion of a faith.

But whatever the merits of the communist faith may be, intolerance and persecution, tyranny and repression are surely the evils that democracy came into being to prevent. Liberty has always taken precedence of equality as the end of democracy.

Democracy itself, it is true, may not respect liberty. Democratic institutions do not necessarily make those who enjoy them conform to the principles of individual liberty. If the voters want to subject themselves and their fellows to repressive measures, the repressive measures will be enacted. And, on the other hand, an autocracy or an oligarchy imbued with the principles of liberty may establish freedom of opinion and freedom of the person for everyone on the most liberal basis.

But there is an inherent tendency of democracy to freedom. Indeed where there is not freedom of opinion there can hardly be said to be democracy, however liberal the institutions may be in other respects. Dictatorships like to maintain representative bodies, perhaps even with considerable ostensible powers. But there are no candidates for election other than those completely committed to the dominant party, and probably not even contested elections between rival candidates within its limits. Nor is there any opportunity even to begin to persuade the electors to support any cause other than those put before them by the Government itself.

Genuine supporters of democracy are bound to be supporters of freedom of opinion, and of so much freedom of the person as is necessary to maintain freedom of opinion. But the extent of freedom to be allowed in other directions is a question to be decided on its merits. The discipline of a collectivist State is not inconsistent with democratic institutions. If the electors want to have collectivism, they will apply the necessary coercion to themselves and one another through their Government. A considerable degree of freedom of choice of occupation can be allowed under a collectivist system, but democratic government does not in itself require a maximum freedom in that respect. It would be quite consistent with a very rigid coercion so long as the coercion was not applied to limit freedom of opinion.

But after all it is a profound mistake to treat a party dictatorship as itself a *system* of government or as an alternative to democracies, oligarchies and autocracies and the various blends of those elements that go to make up actual constitutions. A party dictatorship, if it is not to be a mere oligarchy, perpetuating itself by co-option, must be willing to accept adherents who support its principles. If it succeeds in extirpating rival parties, it becomes potentially coextensive with the entire community. Even if a distinction is maintained between the stalwarts who become members of the party, and the rest of the community, some test must be found for the selection of the stalwarts. That raises precisely the problems inherent in all political institutions.

How are the people by whom the Government is to be carried on to be selected? In whom is political power to reside, and how is the Government service to be recruited and disciplined?

A revolutionary movement itself distinguishes the stalwarts at the time from the rest of the community, both from those who have resisted the revolution and from the indifferents. But, once it is accomplished, there is no way of distinguishing the successors of the original stalwarts except by tests of opinion. Tests of opinion can hardly by themselves recruit a governing class. The new system of government once established, the line of least resistance will lead people to accept it, and it will be only a few recalcitrants that a test of opinion will exclude.

Democracy has a stability which no other form of government can attain in a politically conscious population. Any institution which runs counter to the desires of the majority of people is precarious, and democracy means a method of making the desires of the majority felt. Like all systems of government, it can only work imperfectly in an imperfect world. It only works at all in communities where the mass of people can be induced to form opinions on public issues. Where they are unable or unwilling to do so, democracy will fail to afford safeguards against abuses in government.

But where democracy does work, the safeguards it affords are of inestimable value. If the ideal economic system were inconsistent with democracy and involved the abandonment of these safeguards, that would place humanity in a terrible dilemma. But even if the ideal economic system involved the most rigorous and far-reaching discipline, there is no reason why it should not exist under democracy. On the other hand, too severe an economic discipline may itself be a great evil. It may infringe on liberty in other directions than the political. In fact the reconciliation of liberty with economic discipline may turn out to be the greatest problem of our economic destiny.

CHAPTER IV

THE LABOUR MARKET AND COMBINATION

1. THE competitive system is founded on markets, and it is through markets that it attributes value to any economic activity or product. Different markets work in very different ways. Some are in the hands of experts who calculate the prospects of supply and demand to a nicety, and vary prices, often by small fractions, from hour to hour. Others are worked by the method of trial and error, quoting an unvarying price for a time till a cumulative excess either of purchases or of sales calls for an alteration.

Among the markets is that which determines the value of hired labour. Work, as we have seen, is the subject-matter of economics, and under modern conditions hired labour forms a very large part of it. The labour market is one of those that function by trial and error. And it sometimes attains its results very imperfectly.

The problem the labour market has to solve is to arrive at the right value of the services a workman will render to his employer, in the light of the market value of the product to which those services are to contribute. It is the employer who is in a position to estimate this. He calculates his costs, including wages, and, deducting them from the proceeds of sale, arrives at his own profit.

If there were an absolutely fixed standard of profit, the wages in each industry would be governed by the market value of its product, so that labour would be attracted by high wages into prosperous industries and enterprises, and repelled by low wages from those that were depressed. But in practice the principle by which profits are determined, though it supplies an underlying standard, does not prevent wide divergences between different traders and for the same trader between different times. If his product is favoured by a high demand, the trader is in no hurry to share the profit with his workmen; if demand falls off, his first consideration will be to keep his works employed, and, rather than have his productive capacity under-employed, he will accept orders at prices which involve a big sacrifice of profits.

Profits, in virtue of these fluctuations, form a cushion between selling prices and wages, so that wages are more stable than prices. It is when a change in demand passes beyond the limit at which it can be absorbed in profit that a change in wages is called for.

A fall in demand may be so considerable that the producers cannot keep fully employed even at prices which sacrifice all profit. As soon as the loss of profit reaches the limit at which a producer will no longer accept orders, he will begin to restrict output and discharge work-

people. If circumstances are such that those discharged can without difficulty obtain alternative employment in other industries, there may still be no fall of wages. But if these workpeople are too specialised, or if other industries are also suffering from low demand (as at a time of general depression) so that they remain unemployed, there will be a tendency among them to regain employment by accepting lower wages.

A reduction of wages enables the employer to offer the product at a lower price without further sacrifice of profit, and if the lower price is passed on to the consumer, there will probably be an increase in demand and so in the output of the industry. This result, if it can be achieved, may be to the interest not only of employers but of the workpeople too.

That is so especially where the failure of demand is not due to the circumstances of the particular industry but is caused by a general depression (see below, pp. 85–6). A general reduction of wages, along with a reduction of prices which is just sufficient to restore profits to normal, would simply put back the position both of wage-earners and of profit-makers substantially to where they were before the disturbance. The wage-earners would forgo the fortuitous advantage of the maintenance of wages in terms of money units in face of falling prices, and in return would escape the distresses of unemployment.

On the other hand, where the failure of demand is peculiar to one industry, the workpeople have not the gain from a general fall of prices to set against the loss through a reduction of wages. Those with a specialised skill which is of no use in other employment must face the loss arising from a diminished demand for that skill. But a reduction of the wages of those not specialised is not warranted on that ground. Those who lose employment need not accept a reduction of wages if they can find other occupations.

It is sometimes much too readily assumed that workpeople displaced from one industry cannot adapt themselves to another. That is by no means in accordance with experience. There is a perpetual inflow of recruits into new or expanding industries, among whom there can only be a very limited proportion of young people newly entering employment. It is only at a time of general depression that this demand for labour fails to absorb those displaced from declining industries, though of course there must inevitably be some delay in the process and some loss in respect of specialised skill.

A rise in demand for the product of an industry will in the first instance evoke increased activity and employment. When the industry is employed up to capacity, it will take effect in a rise of the price of the product and so of profits in the industry. Provided the labour supply of the industry is sufficient to man its plant at capacity, there will at that stage be no pressure on the employers to pay higher wages.

Unless, however, the rise in demand is thought to be temporary, the high profits will lead to extensions of capacity and the industry must then attract additional labour. Even then higher wages will not necessarily be offered, for there may be surplus labour in the market, which can adapt itself to the industry. And indeed, if the enlargement of capacity goes far enough to satisfy the increased demand, wages should not be permanently above the prevailing level.

So long as general demand remains unchanged, that is to say, increases in demand for some products are offset by decreases in demand for others, no change in the level of wages is called for. But if there is an expansion of general demand, so that the demand in terms of money for all products increases (see below, pp. 79–80), or at any rate the increases of demand substantially outweigh the decreases, the immediate result will be an increase of prices and profits, and an increase of wages corresponding to the increase of prices would be required to reduce profits to normal.

How is this increase of wages to be brought about? Most industries have some reserve capacity of plant, so that industry can in the aggregate employ a number of workpeople in excess of the available supply. Even therefore without any accelerated extension of capacity, a scarcity of labour may be experienced. If the high profits lead some industries to extend capacity, this scarcity of labour will be intensified.

But it cannot be taken for granted that the scarcity of labour will lead to a rise of wages. The employer who offers a rise of wages when he cannot find free labour is in effect trying to tempt away other employers' workpeople. He is entering into a form of active competition comparable to price-cutting. And the result is likely to be very similar to that of price-cutting; if one starts it, all the rest must needs follow, and none will gain. All will find themselves paying higher wages, and the supply of labour will not be appreciably increased. Equilibrium will be restored not by the appearance of more workpeople but by a reduction of profits, which will make employers no longer seek to enlarge their output.

If the employers are far-sighted enough to anticipate this prospect, they will probably be restrained by a tacit accord from competing in the labour market by offers of higher wages. They will confine themselves to making such offers to any special skilled grades which are disproportionately scarce, and the recruitment of which can be stimulated by better remuneration.

And there is another way in which employers may react to low wages. The apparent scarcity of labour is simply the consequence of the intensified demand for it on account of its cheapness. When the existing workpeople have been absorbed into employment this demand can no longer be met from additional numbers. But the supply of labour can still be increased by exacting more work from each man.

The employer who wants to increase his output may put pressure on his workpeople to work harder, or may require them to work longer hours. They may find themselves suffering doubly from their unfavourable bargain, being overworked as well as underpaid. And the increase in the amount of work done staves off the scarcity of labour which might otherwise tend to break down the tacit accord of employers and start competitive offers of higher wages.

It follows that, if the labour market is left to itself, wages may lag far behind rising prices and profits, and workpeople find themselves at a serious disadvantage under those conditions. Nor is this disadvantage compensated by the resistance of wages to a fall at a time of falling prices and shrinking profits, for that gives rise to unemployment. And there is a further difficulty at such a time, in that no one can say how great a reduction of wages is necessary to restore activity. The appropriate level has to be found by trial and error, and the wage reductions, if persisted in till full employment is reached, are likely to overshoot the mark.

2. The wage-earners are at a heavy disadvantage in bargaining. The other party to the wage bargain has everything on his side. The bargaining power of anyone who is buying or selling something depends on his power to refuse terms and on his knowledge of the limitations of the other party's power to do so. Refusal may mean a willingness to do without the purchase or sale altogether, but more probably it is supported by a hope either of finding someone else who will concede more favourable terms or of market conditions themselves becoming more favourable at some future time. The workman seeking employment cannot afford to remain unemployed. Every day that he fails to sell his labour is an irretrievable loss. Even if he could foresee a time of higher wages coming, he would still prefer to take employment at existing wage rates and apply for higher wages later on rather than wait on unemployed. And in any case he has not the means of judging of future market conditions. It is the employer whose business it is to forecast the demand for his product, and consequently the derived demand for labour to produce it.

Nor has the individual workman any prospect of getting better wages from another employer, apart from the quite exceptional conditions when the tacit accord of employers is breaking down in face of a scarcity of labour. There are indeed sure to be many workmen in more or less permanent employment who have attained a personal relation with their employers, and whose wages are not rigidly limited to the rate appropriate to marketable services. But these are outside the active market, and, however exceptional their wages may be, the market is always in the background as a standard of comparison. The man who is a mere unit in the market cannot afford to ask higher wages than his fellows, or no employer will engage him.

It will be seen therefore that, whereas in given economic conditions there is an economic level of wages just low enough to allow that margin of profit which will ensure full employment, the market rate of wages is only too likely to fall below that rate, and even to remain below it almost indefinitely in consequence of the weak bargaining position of the wage-earners.

The wage-earners have found their remedy in collective bargaining. Those employed in an industry combine to associate together in a trade union (a labour union, as it is more logically called in America). They choose leaders whose function it is to take opportunities of demanding improvements of wages or of conditions of employment, and so far as possible to resist reductions of wages or any deterioration of conditions of employment. The leaders' bargaining power is enforced by the refusal of the workpeople to accept employment on any terms not agreed to. In case of a failure to agree, they can 'strike.'

A strike, a concerted refusal to work for an employer with whom there is a dispute, is not a normal accompaniment of collective bargaining. If prolonged, it puts a severe strain on the workmen. But it does put pressure on the employers, and, at a moment when they *can* afford to make concessions, the threat of a strike, or even the unexpressed possibility of a strike as the background of negotiations, is likely to be effective. At a time of high demand the industry cannot afford to be idle. Provided the strike is confined to the concerns of those employers who *refuse* the desired concessions, and the workpeople continue to work for those who grant them, the latter get business away from the former. Only if the demands are such that most or all employers feel bound to resist them will this pressure fail.

Combination among workpeople leads to combination among employers. Tacit accord not to raise wages makes way for express agreement. If both sides adhere to their undertakings, a strike, actual or potential, extends throughout the industry, and the negotiations are between the whole body of workpeople and the whole body of employers. Workpeople have found great difficulty in inducing all those employed in an industry to enter into combination. That was especially so in the early stages of trade unionism, and there resulted acute antagonism both against those in an industry who refused to join and support the trade union, but who enjoyed the fruits of its struggles when better conditions had been won, and still more against the 'blacklegs' who came in from outside the industry to take employment in place of strikers. But these difficulties have been so far overcome that collective bargaining has become the normal method of settling wages and conditions of employment in the big industries in Great Britain. Organised labour has become an established institution, and has spread throughout the world.

Collective bargaining is directed to regulating not only rates of

wages but conditions of employment generally. The contract of employment binds the workman to submit to the employer's discipline, to use his plant and to work for the prescribed number of hours in the day. Left to his own discretion, the employer will organise the whole concern in whatever way will make his costs least and his profits greatest.

Hours of work and rates of wages are intimately related. As we saw above (p. 61), if wages are below the economic level, and profits correspondingly high, traders will try to expand their output to take advantage of the favourable conditions. When the limit of full employment is reached, and the traders experience a scarcity of labour, they may obtain an additional supply of labour by increasing the weekly hours worked. Marx in *Das Kapital* exaggerated the tendency of the competitivist employer to exact excessive hours. According to the rigid theory of the subsistence wage, he supposed that the weekly cost of a workman would approximate to a fixed standard so that the hourly cost would be inversely proportional to the number of hours worked. But even without that fallacious assumption, it remains true that so long as the hourly wage is below the economic level, there is an inducement to employers to exact long hours.

Organised labour tries to keep wages up to the economic level, but it cannot be sure of always doing so, and has therefore to be on its guard also against excessive hours.

Unrestrained profit-making may lead to a general neglect of the workpeople's welfare. Employers may fail to take adequate precautions for the health and safety of the workpeople, let alone for their convenience and amenities. From the profit-making point of view an improvement in these respects means additional costs, and is therefore the subject of bargaining on the same footing as wages. It demands the machinery of collective bargaining even more obviously than wages, for the individual workman can ask for his own wages to be raised, but can hardly ask for the organisation and practices of the employer's whole enterprise to be altered.

There may be some concessions that the workpeople can ask for in regard to conditions of employment that involve little or no extra cost, but usually cost is involved, and cost imposes the limit on what the employer can grant. The limit is imposed on costs as a whole, so that for the purpose of estimating it, wages and conditions of employment must be taken together.

Thus collective bargaining covers a wide field. The employer regulates a large part of his workpeople's life. I have compared him with a feudal lord. The employer's ownership of his enterprise gives him almost as much authority as the feudal lord's ownership of his land. The feudal lord might make a bargain with his tenants, for instance for a commutation of onerous services for money. But there is no

very close parallel here to collective bargaining with labour. The tenants were not free to move, nor was the lord free to remove them. Even when the right of free alienation of land developed, the absence of anything like a free market in practice prevented any extensive movement till medieval conditions had become a thing entirely of the past.

The workman's freedom to move is often circumscribed by practical conditions. He may have a special skill which ties him to his existing occupation, and he may have local ties which prevent him from moving to employment in the same industry in another place. In an industry where those conditions predominate a strike resembles a strike of tenants. Indeed strikers usually look forward to being employed by their former employers when the dispute is over. They withhold their labour as a body with a view not to finding other purchasers of it but to putting pressure on employers who are unwilling to see their works idle. The freedom of the modern labour market is a reality, for a large proportion of the workpeople do find opportunities not only of changing employers but of changing occupation. But this is done by individual choice, not by collective bargaining.

3. The organisation of labour, however, is likely itself to impose limitations on freedom. Mayne once described the evolution from medieval to modern society as a change from a basis of status to one of contract. Trade unionism may be regarded as a reversion to status. A man joining a trade union, though he binds himself by a voluntary contract, nevertheless thereby imposes on himself a status. The conditions of his contract with an employer are to a great extent determined for him by the trade union. The trade union's bargains with employers are free contracts, not prescribed by law or custom, but to the individual workman they have much the same aspect as law or binding custom. And the process of either making or amending them has something of the formality and cumbrousness of legislation.

The trade union is deeply concerned in its own membership. It seeks to include as nearly as possible all those whose calling brings them within the sphere of its bargaining. That usually means all engaged in a particular kind of industrial operation, or, alternatively, the aim may be to include all those in one industry, whatever the variety of operation they may be occupied in. Thus the engineers employed by a railway may belong to an engineers' union, and the clerks to a clerks' union, or it may be that all railway employees belong to a railwaymen's union. Whatever the method of demarcation, the union will seek to strengthen its bargaining power by attracting into its membership everyone within the boundary, and may even endeavour to prevail on employers to refuse to employ non-members.

Every trade union is intent on the interests of its own members.

It may exact concessions which increase costs of production and the employers may be compelled in consequence to raise the price of their product. Sometimes their power of doing so is limited by foreign competition, so that a rise of wages beyond what the industry can stand will threaten it with destruction. Some industries, however, are free from foreign competition, and the only limit is imposed by the shrinkage of demand when consumers have to pay higher prices. Strong trade unions in these 'sheltered' industries may secure disproportionately high wages at the expense of their neighbours, but to do so successfully they must restrict the entry of recruits into their industries—for example, by customary rules as to apprenticeship or training. If their agreements with employers can be so devised as to secure this condition, the trade union members get their wages increased by what are in effect monopoly earnings.

That is an abuse of collective bargaining. If the strong trade unions limit recruitment of their industries, the numbers left to find employment outside those industries are so much the greater, and are less favourably placed to secure good wages.

To get the most out of their monopoly the trade unionists may resort to a limitation of output. A standard output may be a valuable safeguard against workmen being overdriven. Not only is it an employer's interest to exact more work from his men when wages are below the economic level and he experiences a scarcity of labour. But when wages are *high*, he will try to recoup himself against the rise of costs in the same way. In either case labour has become precious to him, and he endeavours to make the most of it.

If he does no more than level up their work to a standard which the workmen can sustain without strain, that is all to the good. But he may carry the process to excess, and the trade union will then justifiably intervene.

But that is not the sole motive for a limitation of output. It is sometimes resorted to when there is unemployment with the idea of spreading a given amount of work over greater numbers. When unemployment is due to the fact that business is not remunerative to the producer, an expedient involving an increase of costs is no remedy. To avoid an increase of costs, the spreading of work would have to be associated with no greater pay per unit of output and therefore with weekly earnings diminished in proportion.

But sometimes the underlying motive of a restriction of output is to take advantage of the monopolistic position of a trade union. Its monopolistic position depends on its power of limiting numbers, but if the numbers available in the industry or craft are already in excess of the limit contemplated, and it is impossible to exclude some of them, the desired effect may yet be secured by an understanding among the workmen to restrict the output of each to an agreed limit. That means

of course that whatever increased cost the monopolistic power of the trade union succeeds in imposing upon the employers is spread over larger numbers and yields less in weekly earnings to the individual. But there is in practice likely to be a limit to the weekly earnings that the workmen can get without exposing themselves to invidious comparisons with those in other industries less favourably placed. Where the process on which they are employed forms only a very small part of the cost of the final product, an unrestrained monopoly power might raise the payment for it to a fantastic level, without very greatly affecting the price to the consumer or the volume of sales. If a group of workmen used this power to raise their weekly income to, say, five times what those of similar attainments in other industries could earn, they could hardly expect their monopolistic practices to be tolerated. But if they secure high but not extravagant earnings for larger numbers, the abuse of their power is not so evident.

Trade unionism is not peculiar among human institutions in being open to abuses, and it is not to be condemned on that ground alone. When combination spreads from skilled to unskilled grades, so that wages are settled by collective bargaining practically throughout the whole of industry, some of the inequalities are redressed, though the advantages of sheltered industries remain, and the temptation to limit output may spring up in all grades. But there is in any case a limit to the benefits that can be obtained through collective bargaining. It is no advantage to push up the general level of wages beyond that at which full employment is secured. So long as enterprise depends on profit, costs cannot encroach on profits without diminishing enterprise. The workpeople pay dearly for a rise of wages if it inflicts unemployment on them. Theoretically indeed the unemployment might in some circumstances be less than in proportion to the rise of wages, so that the aggregate receipts of the wage-earners would be increased, but a calculation which disregards the distresses and anxieties of unemployment fundamentally misrepresents the position.

In a country where the greater part of industry is exposed to foreign competition, the adverse effects of a rise of wages are likely to be quickly felt; and if the country's competitive power is restored by a depreciation of its monetary unit in the foreign exchange market, the result will be simply to nullify the rise of wages by a corresponding rise of prices, re-establishing the former relation between wages, prices and profits.

In a self-contained community this corrective would not operate. But even there unemployment could only be eliminated if a sufficient monetary expansion were brought about to restore profits. Failing that, unemployment would not only continue but it would grow, as existing enterprises dropped out and found no successors, till eventually only the more profitable would survive. At last the old relation of

wages, prices and profits would emerge with little alteration, but under conditions of chronic under-employment.

The special distresses of unemployment could be avoided, it may be said, by spreading the available employment over the aggregate working population through a reduction of weekly hours of work. But if full employment even on that basis is to continue, employers must still be secured normal profits. That must be so whether weekly earnings, hourly earnings, or earnings per unit of output are kept constant. The diminished hours mean a diminished output of wealth to be shared among employers and wage-earners, and the profit system still remains to prevent the latter from getting any but a purely fortuitous increase in their proportion.

Undeniably, increased leisure may be a gain worth having at the cost of diminished wealth. But that is quite a different issue. The point is that any attempt to force wages up beyond the level corresponding to full employment will fail eventually either to capture a part of profits or to increase the proportion of the available output secured by the wage-earners. It can only result in a diminution of the total wealth to be shared. There will not only be less for wages, but less for accumulation, and the taxable capacity on which the community draws for the cost of Government, including both defence and social services, will be diminished.

4. Thus collective bargaining has in reality a strictly limited scope. It is an invaluable safeguard against the encroachment of profit-making upon wages; it can prevent a depression of wages below the economic level, and it can obtain desirable conditions of employment. But it cannot get concessions which force the cost of labour to employers above the economic level, without provoking reactions which will defeat its purpose.

The combination of workmen cannot be a corrective of the tendency of profit-making to inequality. But, possibly as the outcome of the limitations of collective bargaining, combination has had a profound influence on the working of democracy. Trade unionism has formed the basis of a labour party capable of political action, and it has gone far to counteract one of the greatest defects in the practical working of democracy, the advantage of wealth in the organisation of opinion.

In nineteenth-century England the selection of candidates for the House of Commons was limited almost exclusively to men of means who could provide the heavy cost not only of the actual electioneering, with the necessary organised meetings, publicity and canvassing, but of the party organisation and of the 'nursing' (not to say corrupting) of the constituency in the interval between one election and the next. The Reform Act of 1832 actually aggravated this evil by increasing the number of electors, and eliminating the rotten boroughs, the

patrons of which would often be willing to nominate promising young candidates without involving them in expense.

As successive Reform Acts brought further increases in the number of electors, efforts were made to limit the expenses of elections. But the field of selection of candidates was not effectively extended beyond the circle of the well-to-do till the Labour Party came on the scene and put forward its own candidates, with the advantage of an existing local organisation and trade union funds collected from a wide membership in small contributions.

Members of Parliament who reached election through this channel could represent the wage-earners more faithfully than middle-class members attached to the old parties. Perhaps too faithfully. Democracy requires elected legislators both to represent the interests of their constituents and to see political issues from a national standpoint. A party may represent the interest of a class, but it must also contribute to decisions on matters of national interest. The policy of a democracy in which sectional interests, whether those of classes, localities or any others, predominate over national interests will be vitiated.

This is one of the gravest dangers not only of democracy but of all systems of government. Indeed democracy is less exposed to it than other systems. The exercise of power by the mass of the people is a safeguard, even if an incomplete one, against the abuse of power by a limited governing class. It is incomplete because the voters have regard to their individual interests as well as to the public interest, and combinations of individual interests may deflect policy.

Democracy exacts much from human nature. It requires every voter to be a statesman. That is contrary to the division of labour, which would require the art of government to be entrusted to those who specialise in it. Even under democracy that division of labour exists. Government is entrusted to leaders who decide policy, and who carry on administration through the instrumentality of a specialised civil service. The corrective applied by the mass of voters is limited to the power of their representatives on occasion to refuse consent to the Government's measures or to insist on a change of Government. It is when the representatives offer their candidature to the voters that the latter are called upon to form views of the public interest in a spirit of statesmanship. The representatives, being elected only for a limited time, and having to subject themselves at intervals to re-election, reflect the views of the voters. If voters have regard only to their own direct interests, they will select representatives who will take an equally narrow view. If the representatives are financed by contributions from their supporters, their dependence on the latter will be all the greater.

When trade unions finance a parliamentary labour party, they expect their representatives in parliament to support measures in furtherance

of trade union policy, whether by safeguarding and reinforcing the legal position of trade unions, or by securing legal sanctions for rates of wages and conditions of employment which would otherwise depend on collective bargaining.

Organised labour is bound to be a great power in a democracy—so much so, indeed, that the other political parties cannot afford to oppose its special demands. They must concede what the wage-earners regard as really essential, for they cannot face united action on the part of the wage-earners on any issues affecting the interests of the latter that continue to be a field of political conflict.

And the very power of a labour party compels it to look beyond considerations of immediate labour interests and to take account of the interests of the whole community. So far as wages and conditions of employment are concerned, they encounter the inevitable limit. They cannot encroach on profit beyond the limit without discouraging enterprise and exposing the wage-earners to unemployment.

Labour parties tend therefore to challenge the profit-making system. They attack competitivism itself and become socialist parties.

The collectivism of the socialists, social democrats, and labour parties of the present time is apt to be rather academic. Those who devote their political action to it as an immediate practical issue usually take the communist label. A labour party has to appeal for the support of wage-earners without regard to their views on collectivism, and, even if its supporters are on the whole believers in collectivism, the transition to a fully developed collectivist system is so vast an undertaking that the leaders themselves, however convinced of its desirability, are likely to be daunted by the task when accession to power puts the responsibility upon them.

They content themselves therefore with taking advantage of such opportunities as offer for nationalising enterprise by way of exceptions to the competitivist system. They also support the extension of social services financed by direct taxation. But on the whole the social services have been initiated rather by the old parties (conservative sometimes as well as liberal) than by organised labour.

It would be a mistake to exaggerate the bias in favour of property among the men of means from whom candidates had to be chosen before the advent of the labour party. There was never any difficulty in finding representatives of advanced views among them. The pursuit of wealth is a powerful motive, but so is ambition, and both may be subordinated to public spirit or devotion to ideals. The advantages of the wealthy classes were to be found rather in their power of paying directly and indirectly for political propaganda than in a monopoly of candidates. And even there the idea of a tacit agreement among them to exclude attacks on property from newspapers, speeches, books and pamphlets was sheer fiction. The sanctity of

property in the nineteenth century was founded on a deeply rooted tradition which extended to all classes. Supporters of the tradition did not merely seek to preserve their own property; rather they found difficulty in conceiving a state of society in which the right of property was not paramount. The collectivist schemes that were promulgated in the nineteenth century did not go far towards offering a constructive alternative.

5. The diversion of trade unionism to the formation of labour parties and socialist parties was due to dissatisfaction with the limited power of combination so long as it was confined to bargaining with employers. Parallel with it there occurred another intervention in the political sphere, with more dangerous implications.

As organised labour grew in strength, and the employers in any industry were impelled on their side to combine, and to present a united front in resisting demands or enforcing their own standards, society began to be harassed by stoppages of work extending over entire industries. Especially calamitous were those affecting industries, such as coal mining or transport, on which many other economic activities were dependent. Coalminers and railwaymen were beginning even before 1914 to count on putting pressure upon the Government and the entire community, in the hope of procuring through legislation concessions which they could not extort from their employers.

A strike with that motive is an approximation to civil war. Its aim is to extort concessions by inflicting or threatening injury. The policy is the same as that of the general strike, which has long been advocated as a revolutionary weapon. The idea of a general strike goes back to the secession of the Roman plebs to the Mons Sacer in 494 B.C., which formed the occasion of Menenius Agrippa's parable of the rebellion of the limbs against the belly. The general strike was advocated as a political weapon by some of the Chartists a century ago. And the Communist Manifesto, when it appealed to the workers of the world to unite, looked to strikes as at any rate one of their weapons. Attempts have been made in the twentieth century to organise general strikes in several countries, notably in Great Britain in 1926 in support of the coal miners, but in no country hitherto has it played a decisive part in a successful revolution.

A strike that is intended to extort concessions from the sovereign power, even though with no political or revolutionary object, is none the less an approximation to civil war. The purpose may be limited to matters in dispute between employers and workpeople, but the method is a threat of injury to the entire community.

Here is a rival to the organised force of the State. The existence of two rival powers wielding organised force in a single community leads to anarchy. It is rival sovereign powers that constitute the international anarchy. The singleness of sovereignty in a community

means the singleness of control of organised force. Anything that endangers that singleness endangers peace, order, liberty and welfare.

There are often to be found tendencies latent in a community, which might, if they persisted, cause a cleavage in the control of organised force. When the sovereign power circumscribes, represses or persecutes a section of the people, whether on grounds of race, religion or opinion or of some divergence of interest from its own policy, there is always the possibility of resistance, and in such matters the loyalty and unity of the police and armed forces cannot always be taken for granted.

When organised labour begins to threaten the community with strikes so planned as to dislocate economic life, it is coming very near that state of things. It may be acting within the law. But if the law permits action which is in fact anarchical, that does not alter the character of the action or prevent its consequences. It is difficult to find legally tenable definitions of the concerted actions of associations, and much ingenuity has been applied both by legislatures and by courts of law to making strikes either lawful or unlawful, and drawing the line between the one kind and the other. The difficulty is partly due to the ambiguity of the facts themselves.

A strike, unless it is an avowedly revolutionary movement, will be directed against employers, even if it is also directed against the community. And the strikers and their families are themselves members of the community. They suffer like their neighbours from the interruption of economic activities, as well as from the suspension of their own earnings. And the community does not repudiate its ordinary responsibilities for the relief of distress, even when the victims are participators in the strike that is causing the distress. A strike of this type is a strange and paradoxical conflict, in which the antagonists are never clearly aligned. Indeed it is such an absurdity that it could not succeed and could hardly even be ventured upon unless the strikers' cause, on its merits, excited a great measure of public sympathy.

It is the lack of any clear standard of what is just or reasonable in holding the balance between wages and profits that leads to disputes. If such a standard existed, either side would forfeit sympathy and support if it demanded more than a fair standard would warrant, and it would hardly be possible to engage a body of workpeople in a conflict attended by loss and distress for a palpably bad cause. The community would find ready means of imposing a recognised standard on recalcitrants, whether employers or employed.

6. Organised labour is a source of power. It possesses its own discipline, resembling in a mild and limited form that party discipline which is the principle of the totalitarian State. Its discipline has enabled it both to intervene in the political field by organising a labour party, and to threaten the community with strikes of a quasi-revolu-

tionary character. From it also was derived the idea of the syndicalist movement, which aimed at placing the economic direction of the community, and possibly the political government too, in the hands of organised labour. The socialist plan of nationalising the means of production, distribution and exchange was not deemed altogether satisfactory if it meant handing over all economic enterprise to organs of Government modelled on the Government Departments that had been evolved by the burgessry. Organised labour might supply a differently constituted authority to administer it. The workpeople employed in an enterprise could supersede the responsibility of the shareholders and form a board of directors from their own representatives. And a representative legislature could be constituted on a basis of electors grouped according to vocation instead of being grouped in locally defined constituencies.

The underlying idea was that the working class, if it was to exercise an effective influence over either industry or government, must be represented through its own class organs. The worker when he votes must vote as a worker, not as a denizen of a locally defined constituency.

In its application to Government this was not without plausibility, but it has never gained a footing in practical politics. (The 'corporative State' devised by Italian fascists is a mere travesty divested of the democratic basis which is essential to syndicalism.) In fact representatives chosen by occupational or industrially defined constituencies would be *too* representative; they would represent their electors in one capacity only.

And the syndicalist principle in the government of industry could only be applied within very narrow limits. The functions of the trader are as specialised as those of any of the people he employs. A board of directors usually includes some who have no pretension to possess the essential qualifications, and there would be room among these for representatives of organised labour. But the effectiveness of these for any purposes except advising on the conditions of labour would depend on their individual qualifications, and would not be at all likely to be taken into account in their selection. In fact so long as competitivism remains the governing principle of industry the trader's function is profit-making. Syndicalism never really contemplated labour representatives taking a hand at profit-making. Its aim was rather to devise a form of directorate appropriate to an industrial system from which profit-making had been eliminated. The question of the government of industry in a collectivist community is one to which we shall return later (see Chapter XIX).

CHAPTER V

MONEY AND CREDIT

1. WORK is paid for in money. Every service rendered engenders a *debt* which is expressed in units of money. Every sale engenders a debt from buyer to seller. Money is the medium in which debts can be paid and discharged.

To keep the system going, it is essential that the people who buy goods or services be supplied with money. If they run short, the intending sellers run short too, and the whole is brought to a standstill.

In primitive conditions the supply of money means the supply of some material product which is used as a medium, such as the precious metals. In a state of society in which those working on the land provided their own subsistence, either as independent peasants or in village communities, and where the subsistence of workmen was provided in kind by employers, pecuniary transactions were limited to superfluities. People who were in a position to save and to acquire superfluities accumulated hoards of gold and silver, and drew on their hoards to make payments.

But even in primitive conditions merchants and traders avoid the inconvenience of settling every transaction by immediate payment. If traders can trust one another, payment can be deferred, and debts can be set off against one another, leaving only a balance to be settled in gold or silver or whatever medium is appointed to be used as money. The great periodical fairs of the middle ages became occasions for mutual settlements among merchants.

In other words recourse was had to *credit*. Credit is merely another name for debt. Credit can be used as a means of discharging a debt because a debt can be extinguished against another debt.

Money is quantitatively measurable. A sum of money is expressed in terms of units, such as pounds, shillings and pence, or dollars and cents. Money and debts are expressed in the *same* unit. Originally the idea of a debt was derived from the idea of money, a debt being an obligation to deliver whatever commodity was accepted as money. But once debts had been established as an essential part of the economic system, the monetary unit came to be primarily the unit for the reckoning of debts. By law money is defined in terms of its debt-paying power. When a coin or a note is assigned a specified value, the prior existence of the units in which the value is stated is presupposed.

Credit came to be systematised through banks. Through them the method of payment by ' clearing ' debts against one another was organised and extended. If people deposit their money with a banker, they can settle with one another by drawing on him. That is to say, a

debtor assigns to his creditor a part of the sum his banker owes him by handing or transmitting a cheque or bank-note. When the debtor and creditor have different banks, the banks settle with one another by clearings of cheques and bank-notes.

Bank credit, consisting of debts due from bankers assignable from one creditor to another by the instrumentality of cheques or bank-notes, has become the principal means of payment in trade and business. The term 'money' is sometimes used in a narrow and strict sense to mean only such coins and paper currency as are legal tender in the discharge of debts. But it is also, and perhaps more usually, used in a wide sense to include those forms of bank credit which are used in practice as the means of payment.

The banker is the debtor of his customers. His debts take the forms of bank-notes and deposits which can be assigned from one person to another. The debts, if they are not to be subject to the inconvenience of a discount, must be due on demand. (Time deposits, which are subject to notice, of a week, a month or more, and yield interest, cannot be transferred except after giving the agreed notice.) The banker must be in a position, like any other debtor, to pay his debts in money whenever a customer so requires, and he must hold a reserve of money for this purpose. The customers suit their own convenience in leaving the greater part of their current funds in the form of bank credit, and the reserve required to meet their demands for hand-to-hand currency is only a fraction of the banker's total liabilities.

The banker, however, must also be in a position to pay any adverse balance at the clearing with other banks, whenever his customers happen to make payments in excess of their receipts. Accordingly he must ensure that the assets he holds against his liabilities, in so far as they are not actual money, contain a sufficient proportion of short-term investments which can be turned into money quickly and without loss of value. Bankers meet this need by lending money for short periods, ranging from a few days to several months, in the forms of bills of exchange, loans on securities or on commodities, or overdrafts. In fact, they take upon themselves a part of the function which would otherwise be discharged by traders giving credit to one another. A trader selling on credit to another trader may, by agreement, draw a bill of exchange on the latter, ordering him to pay the debt when due to whoever at that time may be the accredited holder of the bill. The drawer of the bill can make it payable to his banker, who can then advance him the money (subject to discount in respect of interest accruing in the interval before payment). Alternatively a bank may lend to a customer to enable him to make immediate payment for goods bought, or for any other purpose arising in the course of his business.

It is in the banks' lending operations that the elasticity of the credit system is to be found. When a bank lends to a trader, two debts are created, the debt due from the trader to the banker falling due after an agreed interval of time, and bearing interest meanwhile, and the debt due from the banker to the trader, which is payable on demand, but can be assigned to another creditor, and used as a medium of payment. By this process bank credit is created, and the supply of the means of payment is extended.

It cannot be extended without limit. Any one bank that outstrips the others in lending will find itself paying away adverse balances at the clearing, when its customers draw upon the sums put at their disposal. That does not limit the amount of credit that can be created by *all* the banks if they act together and no one of them lends faster than the others. But the whole body of banks will encounter another limit in the supply of money. When they expand credit, the requirements of the public for hand-to-hand currency will be correspondingly expanded. If the only available currency is coin composed of the precious metals, the supply is limited; if credit is expanded too far, the banks' reserves of currency will be depleted, and they will be driven to contract credit again.

2. The establishment of a central bank, with the right of creating currency in the form of legal tender notes, extends the limit. Its notes supplement or supplant the metallic currency, and are physically capable of any degree of expansion. The other banks make the central bank their bank; they hold balances with it, and can draw on their balances either to obtain currency for the use of their customers or to settle the clearings with one another. And they reinforce their balances, when reduced by these operations, by borrowing from the central bank. The central bank in virtue of its power of creating currency becomes the lender of last resort.

An unrestrained power of creating currency is a danger. In the centralised credit system which grew up in the nineteenth century, restraint was applied in the form of convertibility of the paper currency issued by the central bank into gold coin, and the central bank was required by law to hold a gold reserve, related in some prescribed manner to its note issue. The note issue of the Bank of England in excess of a fiduciary issue of fixed amount had to be covered by an equal metallic reserve. That system was imitated by some other countries, but other formulas were sometimes adopted, requiring, for example, a prescribed proportion of the note issue to be covered by the reserve.

A centralised system of paper currency so regulated could be regarded as merely an adaptation of the free gold standard favoured by competitivism. A bank-note, even though legal tender, so long as it remained convertible, was a right to receive gold. All pecuniary

rights therefore were directly or indirectly rights to receive gold. The commodity, gold, even if coin were superseded by paper currency in internal circulation, remained an international monetary medium. Convertibility into gold was equivalent to convertibility into the money of any other gold standard country throughout the world.

Yet the institution of legal tender paper currency did provide an instrument for Government interference in the monetary system, and so paved the way to another departure from let-do.

Up to 1914 the departure was inconsiderable. The responsibility of the central bank for regulating credit was indeed fully recognised, but its discretion was rigorously circumscribed by the gold standard, and the reserve requirements were only suspended at moments of crisis, when any limitation on the assistance to be given by the lender of last resort would threaten the credit system with general bankruptcy.

Periodical financial crises were the penalty of excessive expansions of credit. Blind adherence to convertibility into gold and to reserve proportions did not suffice to prevent these excessive expansions. The commercial banks could go a long way in the direction of excessive lending before the corresponding demand for currency came to be fully felt. The central bank intervened to check excessive lending only when the demand for currency made its reserve proportion visibly inadequate. It could then take action by refusing to lend, so that for the time no more currency would be created, and the repayment of indebtedness previously incurred to the central bank would result in a rapid reduction of the currency already in circulation. But early in the nineteenth century experience showed that flat refusal by the central bank to lend was disastrous. It was a dereliction of its duty as lender of last resort, and would involve solvent traders in acts of bankruptcy. The practice therefore grew up of employing the bank rate, the rate of interest at which the central bank would lend for short periods (primarily through the discount of bills), as an instrument for deterring borrowers, without absolutely refusing to lend. When credit had been unduly expanded, a rise of bank rate would reverse the process. The commercial banks, when they lent money to their customers, had to have regard to the possibility of their being thereby driven to borrow from the central bank, and they charged the borrowers as high a rate as they would themselves have to pay in that contingency. In fact the central bank, as the source of currency, was in a position to control the market in short-term lending. Market rates of short-term interest followed bank rate.

A high short-term rate of interest, 'dear money' as it was called, retarded the creation of credit by deterring borrowers. It was a milder alternative to a refusal to lend. It was moreover a signal to the commercial banks of the central bank's intention to contract credit,

and a warning to them to exercise a certain discretion in the direction of restricting or refusing advances to customers.

Bank rate policy could be assisted and reinforced in several ways. The central bank creates money whenever it acquires an asset, and extinguishes money whenever it parts with one. When it raises or lowers bank rate, it still leaves the initiative to intending borrowers. If they do not respond fast enough, it can reinforce its action by itself taking the initiative; it can reinforce a rise of bank rate by selling securities in the open market; it can reinforce a reduction of bank rate by buying securities. In the former case, the sale of securities extinguishes money and tends to create a shortage of the commercial banks' reserves. They can only make good the shortage by borrowing from the central bank, and so bank rate is made 'effective.' The purchase of securities creates money, and tends to increase the commercial banks' reserves. The commercial banks do not want to hold an unnecessary amount of idle money, and they will seek to get rid of the redundant surplus by lending more freely. Lending still leaves the initiative to the borrowers, the banks' customers, but the commercial banks themselves have the alternative of buying securities in the investment market.

When the central bank system was introduced into the United States by the Federal Reserve Act of 1913 (one Federal Reserve Bank being constituted the central bank in each of twelve regions) the power of the central bank over its member banks was supported by a legal obligation imposed on the latter to maintain a reserve on deposit at the Federal Reserve Bank in a prescribed proportion of their own deposit liabilities to their customers. By recent legislation power has been taken to vary the prescribed proportions. Credit can be restricted by raising them or relaxed by reducing them. This is not, however, an *alternative* to the use of bank rate, but a supplement to it. When the prescribed reserve proportions are raised, a rise of bank rate may still be required to deter the member banks from restoring their reserve to the required level by borrowing from the Federal Reserve Banks.

From 1934 onwards the Federal Reserve Banks were being flooded with imported gold, and the purchase of the gold at the fixed price of $35 an ounce by the U.S. Treasury created deposits which became reserve deposits to the credit of the member banks. These reserve deposits were swollen far in excess of the old proportions, and the prescribed proportions were doubled in order to keep down the excess or surplus reserves to a more reasonable figure. When a central bank is forced to acquire idle assets in excess of what it can properly absorb, (whether the assets be gold or loans to the Government) the result is to increase the reserves of the other banks, and to impair or nullify the central bank's control over their credit operations. If the central bank cannot be relieved of the redundant assets, its power of control

can be restored by imposing increased reserve requirements on the other banks. But in order to exercise this power it must still be in a position, if need be, to raise bank rate.

3. To understand the need for credit contraction and the manner of operation of bank rate, it will be worth while to digress a little in order to examine more closely the processes and motives involved in temporary borrowing and the creation of credit.

Traders borrow to cover the cost of buying or producing goods, and they repay out of the proceeds of sale of goods. Traders' disbursements may be divided into the payments they make to other traders and the payments they make to the people who contribute, whether by services rendered or by the use of their capital, to the processes of producing, transporting, handling and selling goods. If we take all traders together as composing a single group, the money they pay to one another remains within the group, and what the group disburses constitutes the incomes of the people engaged in these economic activities.

The traders themselves must for this purpose be regarded in a dual capacity, on the one hand as carrying on the business of trading, and on the other as receiving incomes from the profits of their business. In the latter capacity they rank as consumers. Indeed all recipients of income are consumers. A trading concern earns income for its proprietors or shareholders who are consumers. Even its undistributed profits belong to them; undistributed profits form part of the shareholders' savings, and savings are unspent income. Savings are such part of the consumers' income as is not devoted to consumption.

The consumers' income we so define as to make it identical with the value of production. Incomes from wages, salaries, interest, rent, fees, profits all represent services which contribute to form the value of the current output of wealth. Profit enters into the calculation as a balancing factor; being the difference between prices and costs, it makes the ultimate selling value of the wealth precisely equal to the value of the services represented by the incomes.

There are some incomes, it is true, which are not derived from any services currently contributing towards the creation of wealth, such, for example, as the interest on the national debt, so far as not represented by existing revenue producing assets, old age pensions and benefits and allowances provided by the social services, and also income derived from private charity (to say nothing of gambling, fraud and crime). But we exclude these non-productive incomes from the consumers' income, and regard the expenditure of those who receive them as part of the consumers' outlay of those whose resources are drawn on by taxation or charity or in other ways to defray them. Such disbursements may be compared to the breadwinner's expenditure on his family.

The consumers' income is added, as it is received, to consumers' balances of money, out of which come their disbursements on consumption and investment. Investment here means the acquisition of income-yielding assets such as securities or property, and, since consumers not only buy but also sell these things, investment is a net sum arrived at by deducting receipts from disbursements. Consumption and investments together compose what may be called the consumers' outlay. Undistributed profits, although they do not pass through consumers' balances, are included in investments, and payments in kind, uniting income and consumption in a single transaction, are included both in income and in consumption.

'Disposals' in any interval of time are the goods and services which find final purchasers, and cease to be offered for sale. Consumable goods and services are disposed of when sold to consumers. Instrumental goods,[1] the appliances, machines and structures used in production or in any form of economic activity, are disposed of when acquired by traders to be installed for use.

The classification into consumable goods and instrumental goods does not quite fit the facts, because there are consumable goods of an instrumental character. These indeed in theory cover a very wide range, not only houses and gardens, but furniture, utensils, vehicles, ornaments, clothes. All these, in contrast with such things as food, fuel, cleaning materials, drugs or cosmetics, which are destroyed by a single act of consumption, are kept in use till worn out or replaced. Only a very limited selection of them, however, can for practical purposes be regarded as objects of investment. These, which may be called instruments of consumption, may conveniently be confined to real property, such as houses, gardens, parks or game preserves. They are distinguishable from the rest in that they are ordinarily regarded as yielding an income, in kind, if occupied by an owner, in money, if let to someone else. Consumption we will define to include the income value of these instruments of consumption, together with the outright expenditure on all the other consumable goods. The expenditure on acquiring the instruments of consumption so limited, together with that by traders on instruments of production, makes up 'capital outlay.' 'Disposals' are the total of consumption and capital outlay. The part of investment which ultimately meets the traders' capital outlay passes through the investment market. It is applied in the first instance to the purchase of securities, and from the investment market traders raise the necessary funds for their capital outlay, that is to say, for the acquisition and installation of instruments of production.

[1] Often called capital goods. But the term 'instrumental' is more precise, since 'capital' includes the stocks of consumable goods and merchandise comprised in working capital.

There is a *flow* of money taking its source in the economic activity, production, that is, in the widest sense, which generates the consumers' income, emerging in the form of the consumers' outlay to culminate in disposals. The money offered and received for the disposals constitutes *general demand.*

This flow of money must be clearly distinguished from the turnover of money or the total of transactions, which usually figures in monetary theory. The turnover of money is an aggregate, adding together not only all the three phases of the flow of money but also all other transactions in which money passes.

The flow of money may be regarded as a stream of which the consumers' income, the consumers' outlay and disposals are successive cross-sections. The stream is not of exactly the same volume at each cross-section. Between consumers' income and consumers' outlay is interposed a reservoir of consumers' balances, and there may be a difference between inflow and outflow, altering the level of the reservoir. Consumers' outlay and disposals contain an identical element in consumption, but between investment, which forms the rest of the consumers' outlay, and capital outlay, which forms the rest of disposals, there is another reservoir, the investment market, the level of which may be altered by a difference between inflow and outflow. The 'balances' which form these reservoirs may include negative balances in the form of indebtedness to the banks, and, as we shall see in Chapter VII (below, p. 107), negative balances may predominate in the investment market.

Thus disposals may differ from production. An excess or deficiency of disposals is reflected in a decrement or increment of unsold goods in stock. That gives rise to an increase or decrease of orders given to producers. Production (and therefore the consumers' income) tends to be adjusted to fluctuations in demand. Consumers' outlay tends to vary with any changes in consumers' income, and, as the investment market tends to equalise investment and capital outlay, disposals tend to vary with any change in the consumers' outlay.

Therefore, though the three phases of the flow of money, consumers' income, consumers' outlay and disposals, are not equal to one another, an inequality between any two of them tends to correct itself. Since production is adjusted to demand, it increases or decreases (and with it the consumers' income) whenever disposals exceed it or fall short of it. If production reaches capacity in any industry, a further demand leads to a rise of the price of the product, and if an increase in disposals leads to production reaching capacity in all or most industries, a general rise of prices results. If there is a falling off of disposals, so that unsold stocks accumulate, and industries are under-employed, prices are reduced.

Consumers' and traders' balances of currency and bank credit,

being the unspent margin of purchasing power, constitute the quantity of the means of payment on which the quantity principle of money is based. The quantity principle, which historically has supplied the foundations of monetary theory and monetary policy, asserts that the utility of a community's supply of the means of payment, its capacity, that is, to perform its function, is independent of its quantity, because the price level can be so adjusted as to make the wealth value of the supply of the means of payment just what is required. The quantity principle has proved an invaluable corrective of visionary plans for making a community richer by increasing the supply of money, but has only too often been misinterpreted as signifying a simple proportional relation between the unspent margin and the price level. That is an unwarrantable simplification of the mutually related fluctuations of the flow of money, the unspent margin and the price level.

4. Temporary borrowing is sure not to be for the purpose of holding money idle. The money borrowed is destined to be quickly disbursed. It will be spent by the borrower in acquiring some equivalent. A trader may borrow to add to his stock of goods in process or awaiting sale, or to incur capital outlay on installing new instrumental goods. A consumer may borrow to meet some unusual item of consumption, or to acquire investments in securities or in property. A transfer of existing goods from one trader to another amounts to a mere reshuffling of assets, and very likely the sellers repay bank advances as fast as the buyers incur them. But when a trader borrows in order to acquire *new output*, the money borrowed is disbursed to form the incomes of those engaged in the requisite production.

Apart from the produce of the soil, nearly all production is undertaken in response to orders or forward contracts given by dealers to producers. The producer who undertakes to execute an order has to provide money to pay wages and other costs. If his funds are insufficient, he borrows from his banker. When the order is completed and the goods are delivered, he receives payment and repays the advance. The dealer in turn may have to obtain an advance to pay for the goods, but can repay it when he resells them to retailers. The retailers similarly may borrow when they buy, and repay as they sell off the goods to their customers for consumption.

Thus while it is the dealers in goods who take the initiative in ordering more, it is the producers who at the outset incur the borrowing. The dealers' borrowing comes later, when they receive delivery of the goods. But when borrowing is discouraged by a rise of the short-term rate of interest and by an unfavourable disposition of the banks, retailers restrict their purchases from the wholesalers, and wholesalers restrict their orders to the producers. If the wholesalers are to reduce their own borrowing, their orders to the producers must be reduced by more than their sales to retailers. The producers themselves will

restrict their orders to other producers for materials and intermediate products. Thus a restriction of lending will take effect in a diminution of orders to producers; there will be a falling off in productive activity and employment, and therefore also in the consumers' income. A decline in the consumers' outlay and in disposals will follow, and the retailers, experiencing a decrease in their sales, will still further curtail their orders. A vicious circle will be set up, the reduction of stocks causing diminished orders, diminished orders causing diminished incomes and diminished sales, and so calling for further efforts to reduce stocks.

To stop this process, credit is relaxed, the short-term rate of interest is reduced, and bankers become more ready to lend. Retailers are then freer to hold stocks with borrowed money and to take larger and earlier deliveries from wholesalers, wholesalers increase their orders to producers by more than their sales to retailers, productive activity increases, and the resulting increase in the consumers' income is reflected in the consumers' outlay, in disposals and in a reduction of stocks. A vicious circle of expansion may be joined, the contrary of the vicious circle of contraction.

The foregoing description relates to the particular case of bank advances for holding stocks of goods. But bank advances may be obtained for holding other assets. Traders may use them to finance capital outlay, investors or speculators may use them to buy securities or property, or consumers may use them for any exceptional item of consumption expenditure. These bank advances, being added either to investment or to consumption, augment the consumers' outlay.

Bank advances for consumption are probably not very important. In so far as they are amenable to credit conditions, whether the rate of interest or the disposition of the banker, they support the effects of these in other directions. Traders who give credit to consumers, whether by merely allowing time for payment or by systematic instalment selling, provide the means from their own resources, and may have to supplement them by bank advances.

Bank advances for capital outlay and investment are a more considerable factor. Advances to investors or speculators supplement the resources of the investment market, and tend to make the market more favourable to new flotations, and so to stimulate capital outlay. Advances to investors are repaid out of future savings, and advances to speculators out of proceeds of resale. Advances to traders for capital outlay similarly supplement the resources of the investment market in anticipation of future savings, but, as the capital outlay is already arranged, the market does not have to invite new flotations to use the additional resources.

Bank advances for investment, though they may be large in amount, contribute less to the regulation of credit than bank advances for the

purchase of goods. That is so because they are much less sensitive to a restriction or relaxation of credit.

The time for which a trader holds goods in stock can be very easily shortened or lengthened without affecting his sales, so long as he always holds at least an essential minimum. When he purchases goods, he finds it convenient to buy a considerable quantity at a time, several weeks' or even months' supply, and a very slight pecuniary inducement will be a sufficient reason for reducing his average stock by on occasion postponing or curtailing a purchase. He need not even reduce his purchases, if he can arrange later *deliveries*, for it is only when taking delivery and making payment that he has to raise cash.[1]

To reduce or postpone capital outlay, on the other hand, is not so easy. The greater part of the capital outlay in progress at any moment is the result of decisions taken months or years before, and cannot be abandoned or even delayed without serious loss. It is only that small fraction which is the subject of current decisions that can readily be postponed, and much of that may be the subject of plans or commitments too serious to be broken for the sake of avoiding an extra charge of interest over a short period. So long as capital outlay proceeds, the means of payment must somehow be forthcoming for it. It is only in so far as capital outlay is actually diminished that the deterrent effect of credit restriction in this direction is felt.

Where the bank advances are made to the trader incurring the capital outlay, his calculations are directly based on his facilities for getting the advances. Where the bank advances are made for the purchase of securities, the effect is still to be looked for in capital outlay. The purchasers of securities can as easily reduce or postpone their transactions as the purchasers of goods for stock (though in practice they are likely to be interested in speculative gains, and less sensitive to small incidental charges). But it is for the investment market to transmit the effect of any change in the credit position to those incurring capital outlay. It does so through its power of influencing new flotations and sales of securities for raising capital. But this is bound to be a slow business. When banks fail to find borrowers to take sufficient advances, and resort to buying securities, it is similarly through the investment market's power of influencing capital outlay that the expansion of credit has to work its effect.

Even when traders have incurred bank advances for capital outlay or for any purpose other than the purchase of goods, the readiest way of reducing their indebtedness is still by reducing stocks of goods.

[1] In the case of natural products with a speculative market, and with a supply determined by crop conditions, the forward price is so adjusted as to make the purchaser pay the equivalent of what he saves in interest. But in the case of manufactures produced to order that is not usually the case.

5. The essential purpose of the regulation of credit is to modify the *flow of money* in its successive phases of consumers' income, consumers' outlay and disposals. As we saw above, a contraction or expansion of credit is liable to set up a vicious circle which tends to exaggerate its effects cumulatively. Credit restriction makes traders seek to reduce their stocks of goods, and the resulting slackening of production reacts on the consumers' income and disposals, so that they seek to reduce their stocks still further. Credit relaxation encourages traders to add to their stocks, orders are increased, production stimulated, consumers' income and disposals are increased and stocks diminished. The attempt to reduce stocks causes demand to fall off, and the attempt to enlarge stocks causes demand to increase.

Thus credit is *inherently unstable*. That is a serious complication in any measures for the regulation of credit. It makes the steering of a middle course difficult, for any divergence to either side, whether towards expansion or towards contraction, is liable to gain cumulative force, and to require active counter-measures to restrain it.

The practice of let-do under the international gold standard of the nineteenth century always permitted a credit expansion to go too far. When the demand for currency in the gold-standard countries reduced the surplus gold reserves to a dangerously low level, measures of credit restriction had to be imposed, and it was often only through an ordeal of financial crises that the transition to credit contraction was accomplished. Except when wars intervened to disturb monetary conditions (as during the Napoleonic wars, or in the years 1861–6), the alternation of expansion and contraction, each prolonged over several years, gave rise to an approximately regular rhythmical or cyclical movement, a 'trade cycle,' covering from seven to eleven years.

If monetary regulation could have been regarded solely as a means of keeping variations in the wealth value of the monetary unit within bounds for the sake of justice between debtor and creditor, the trade cycle, though a fault, would not have seemed a very serious one from the practical point of view. A rise or fall of prices of, say, 20 per cent. over a period of several years was too gradual to affect very materially the outlook of people entering into pecuniary contracts.

But the fluctuations in the price level were a symptom of the fluctuations in general demand, and the fall in the price level that always supervened by way of a corrective of the rise was brought about by a compression of general demand. That compression of general demand was derived from a decline in the consumers' income and outlay, which in turn meant depressed profits, reduced productive activity, and increased unemployment.

Unemployment has long been the stumbling-block of let-do. When there are people whose services cannot be sold in the market, the happy harmony of competitivism breaks down. When production

is below the capacity of the community the consumers' income generated is sufficient to dispose of the *actual* output; the unemployed portion of the community contributes neither to output nor to consumers' income. There is a pitiful semblance of equilibrium.

The unemployed, it is true, have to be supported, whether from their own savings or by running into debt, or from charity, poor relief or unemployment benefit, and their consumption contributes to disposals. But so much of it as is not derived from the incomes of the rest of the community does not go far to make up the shortage of general demand.

No waste could be more deplorable. The trouble does not arise from the potential services of the unemployed being of a kind that cannot meet existing needs. At a time of trade depression the unemployed are to be found throughout almost the whole range of industry. The services they would be competent to render are of a kind normally in demand, and are only not so at the moment because the spending power of the consumers has been diminished.

The shrinkage of general demand is a monetary phenomenon; a decrease in the flow of money is the very purpose of a credit contraction. It is the monetary dislocation that cuts off the potential demand from the potential supply. The theoretical answer of competitivism would be that the dislocation can be remedied by a general reduction of wages. A reduction of wages in terms of money does not necessarily mean an equivalent reduction of real wages, since the resulting decrease of costs should permit of a corresponding reduction of prices. The relativities of wages, prices and profits might be re-established on a lower plane of money values (except that people with fixed incomes and pecuniary rights fixed in terms of the monetary unit would gain at the expense of the others).

But even if wage-earners could be persuaded to give due weight to this consideration, the difficulty in the way of agreeing on just the right reduction of wages would be almost insuperable. The effects of a contraction of credit cannot be calculated beforehand. As practised in the nineteenth century under the gold standard, it was an empirical operation depending on trial and error. And even if the duration and intensity of the credit contraction could be estimated, it would still be impossible to say with any approach to exactitude just how great a reduction of wages would be required to maintain full employment.

If the reduction of wages is to revive activity, it must be recognised by traders as having reached its limit. So long as they or many of them expect a further reduction of wages, they will defer ordering goods, in the hope that a renewed reduction of costs will enable producers to offer them at lower prices. But if traders are to be fully assured that no further fall of wages is to be anticipated, wages will probably have to be reduced to a level substantially below that which would in reality

correspond to monetary equilibrium. And no one could say at what level that result could be secured.

It is sometimes argued that a reduction of wages would not induce increased activity because it would reduce the purchasing power of the wage-earners, which is itself an important component of demand. That begs the question. For if there is an increase of activity, there is an increase in demand. That is so even if the increase in the numbers employed does not outweigh the decrease in the wages of the individual, for the decline in the demand emanating from the wage-earners is compensated by an increase in the demand emanating from the profit-makers.

The immediate effect of a reduction of wages in any industry is that producers are able to take orders at prices which were previously unremunerative. If after all demand fell off, there would be a fall of price, but only after an interval. It is said that increased profits are not so promptly spent as increased wages. It is of course true that there is an interval of months before increased profits affect dividends. But the expenditure of those who derive their incomes from profit is not rigorously tied down to their cash receipts. Balances and overdraft facilities enable them to anticipate receipts whenever prospects justify expenditure.

If adherence to a metallic monetary standard compels a contracted flow of money insufficient to allow full employment at the existing level of wages, then a reduction of wages is the indispensable condition of avoiding chronic unemployment. But that limiting condition once abandoned, a general reduction of wages can hardly be regarded as a practicable solution of the unemployment problem.

Unemployment remains a vexed problem. If it ranks in the eyes of most people as unsolved, that is because its intimate relation to monetary policy is not fully understood. The trade depression that followed the American Stock Market crisis of 1929 baffled the Governments of the world. Economists had come to recognise a relation between a monetary contraction and unemployment, but still were for the most part unwilling avowedly to advocate letting the monetary system slip into a state of inflation. If any of them did so, Finance Ministers, who were glad to devolve all the technicalities of monetary management on independent central banks, would not listen to them.

There was a time-honoured tradition that the primary object of monetary policy was to avoid inflation, a tradition that had been notably reinforced by the experiences of those European countries which suffered the extremes of inflation in the years 1919–23. An open departure from that tradition was excluded from practical politics, and Governments found themselves confronted with a grave calamity for which they were completely at a loss for a remedy.

Unemployment may be caused by any economic dislocation,

especially by one amounting to a discontinuity. For example, a big change in the character of demand makes certain industries redundant, and a transfer of productive resources from them to other industries which can meet an active demand takes time. Unemployment of that type must be distinguished from that which arises from a disturbance of the monetary system. The former may be called special unemployment, the latter general unemployment.

Special unemployment can be treated by direct remedies, such as the training of the displaced workpeople for industries where they are likely to be needed, the organisation of recruiting for those industries, and the provision of relief where necessary. A zealous statesman can frame such measures and gain public favour when they succeed.

But if he has to deal with general unemployment, he is apt to find that nothing he does makes much difference, and presently both he and the public lose faith and are only too prone to resort to desperate expedients.

It was perplexity and loss of faith that led Germany to give the National Socialists their opportunity. The first electoral successes of the party came in September 1930, in the first year of the depression. When they came into full power in January 1933, the unemployed had reached the fearful total of six million. Their predecessors in the Government of Germany had already introduced inflationary measures, but there had not been time to produce any results. Totalitarian discipline enabled the National Socialists to continue and systematise the measures, and yet at the same time to guard against any lapse into unlimited inflation, because they could prevent any increase in wages. The same discipline was also applied to establish a rigid control of the foreign exchanges, which effectually prevented a visible depreciation of the gold value of the monetary unit, the Riechsmark (see below, Chapter X, pp. 171–2).

6. In the monetary system that was attained by the greater part of the world in the nineteenth century, the gold value of the monetary unit was the fundamental criterion, and the gold value really meant the foreign exchange value. The gold standard linked monetary units together. Where it prevailed, money in any one country could be transformed into money in any other by converting it into gold in the former, and transporting the gold to be converted into money in the latter. So long as international transactions in gold were free, the cost of this transformation was a small fraction of the sum involved, and the rates of exchange between any two gold-standard countries could not diverge far from the gold parity of their currency units, the relative amounts of gold to which their respective monetary laws equated them.

Any country which expanded credit relatively to the others would find that, so long as its currency unit was equated to a fixed amount of

gold, the increased consumers' income meant increased spending power in world markets, so that the country would attract more imports and would tend to lose gold to pay for them. And similarly any country that contracted credit relatively to the others would find that a diminished consumers' income acquired less imports of goods, and gave rise to imports of gold. When other countries were expanding credit, one which expanded, but not fast enough, would import gold, and, when other countries were contracting credit, one which contracted, but not fast enough, would lose gold. Thus all the countries had to keep pace with one another alike in expansion and in contraction of the flow of money.

In the expansive phase of the trade cycle, in so far as they succeeded in keeping pace, none either lost or gained gold, but there occurred a world-wide rise of prices, and a drain of currency into circulation in every country.

When a shortage of gold reserves resulted, a general contraction of credit ensued, in which all countries once again endeavoured to keep pace. They found their monetary units linked to gold at a time when the previous rise of prices was being not merely stopped but *reversed*, and prices in terms of gold were falling. Each had to face the rigours of a credit contraction or deflation, or fail to maintain the gold standard.

The international gold standard had been restored in the years 1924–8, but with a difference. The use of gold coin as a hand-to-hand currency had been abandoned, and the only monetary use of gold was in the reserves of central banks. The central banks were required by law to buy and sell gold at prices corresponding to gold parities, but only in the form of relatively large bars or ingots. This system, known as a gold bullion standard, was devised with a view to economising the monetary use of gold. And it was accompanied by the resort of a number of countries to a gold exchange standard, that is to say, the holding of reserves in the form of liquid assets in the principal gold-standard centres instead of in the form of actual metal.

These devices for economising the monetary use of gold had been recommended by the Genoa Conference in 1922 to prevent the general return to the gold standard from forcing up the wealth value of gold by the competition of a number of countries for monetary supplies. The Bank of France, in the course of re-establishing the gold standard on the basis of a devaluation of the franc in the years 1926–9, had accumulated enormous holdings of foreign exchange in London and New York. In 1929 a great part of this foreign exchange was withdrawn from those centres in the form of metallic gold, which was imported into France and absorbed into the reserves of the Bank of France.

This sudden new demand for gold started a great monetary contraction in the world, and the wealth value of gold was forced up. In

other words, prices in terms of gold units fell. The pressure was caused not, as in the nineteenth-century trade cycle, by the application of a corrective to a preceding state of inflation, but by the abandonment of an expedient previously in operation for economising the monetary use of gold. The pressure was intensified by the American Stock Market crisis in the autumn of 1929, and in the course of 1930 the situation had got quite out of control. The principle of the international gold standard, requiring all countries within its sphere to keep pace with one another, came once again into force; the agonies of depression were being inflicted on each by all the rest.

Had concerted action been possible, all might have agreed to stop contracting credit, and the further progress of the depression might have been checked. Indeed a concerted expansion of credit might have gone further and restored normal activity. By the summer of 1930 there had been a general adoption of low bank rates, 'cheap money' as it is called. But by then the vicious circle of credit contraction had become firmly joined, and cheap money by itself had no longer the power to break it, at any rate within a reasonable limit of time.

7. The depression took its course relentlessly. In the spring of 1931 a new phase started in the shape of a series of financial crises. A persistent fall of prices undermines the solvency of debtors; it reduces the money value of assets, while leaving debts unchanged. That applies not only to borrowers, but to all who make future purchases of commodities, wholesale or retail dealers giving orders for the replenishment of their stocks, manufacturers entering into forward purchases of materials, or speculators buying futures.

To put the same thing in another way, the wealth equivalent of an obligation to pay a given number of monetary units is increased in proportion to the fall of prices. And the fall of prices affects not only traders' stocks of goods awaiting sale, but producers' plant and the shares representing profit-making enterprises.

The series of financial crises began in Austria with the failure of the Credit Anstalt in May 1931; it spread to Germany in June, causing a complete paralysis of banking business, and a default on the country's external liabilities; and in July the contagion reached England. In England there was no banking crisis; the banks were strong enough to bear the strain, and there was no loss of confidence in them. But there was a monetary crisis, a loss of confidence in the maintenance of the gold value of the pound sterling. Even before the world depression supervened, British industry had been in difficulties. The price level prevailing after the return to the gold standard in 1925 was too low relatively to the wage level, wages resisted reduction, and unemployment continued. The sudden fall in the world price level after 1929 was still met by no considerable reduction of wages, and unemployment grew rapidly to an unprecedented figure. The relief

of unemployment imposed enormous charges on the budget, while depression seriously diminished the yield of revenue. Drastic increases in taxation failed to balance the budget. At the same time the competitive power of the export industries was gravely impaired by the high wage level relatively to the world price level. In these various ways the economic system of the country was being subjected to a strain that seemed to be becoming intolerable.

Finally the German crisis suddenly froze up a great mass of short-term loans to banks and traders in that country which had been reckoned among the liquid assets of the British banking system.

In August 1931, recourse was had to a form of international co-operation which earlier in the depression might have averted the catastrophe. The Federal Reserve Bank of New York and the Bank of France lent large sums to the Bank of England (in the first instance £50,000,000 to the Bank itself, and then £80,000,000 to the Government for disposal by the Bank), so that it was possible to satisfy the demand for gold (which was merely the outward and visible sign of a demand for foreign exchange) by selling exchange on New York and Paris.

If the United States and France, the two countries which were absorbing gold, had been willing from the outset to lend to the countries that were threatened with a loss of gold, the strain on the gold supply of the world's credit system might have been avoided, and for the moment the borrowing countries would have been relieved from the necessity of deflation as a condition of maintaining the gold standard, and from the expedients they were put to to restrict imports. But even that would have given no permanent relief unless the lending countries had been able to induce a monetary expansion such as would have permitted a sufficient rise in the world price level in terms of gold units.

When no further credits were forthcoming beyond the £130,000,000 furnished in August, England abandoned the gold standard. What had destroyed confidence in the pound sterling was the strain caused by the fall of prices in terms of gold in world markets. Had the absorption of gold been avoided, there need have been no loss of confidence.

The strain caused by the fall of prices had reached breaking point. When adherence to the gold standard through monetary deflation became impossible, two alternative ways of escape presented themselves. One was simply the reduction of the gold value of the monetary unit. When the Bank of England ceased to sell gold at the prescribed price, representing the historic parity of the pound sterling, the foreign exchange market immediately quoted the pound at a depreciated value in terms of gold and of all foreign currency units that remained fixed in terms of gold.

The other alternative was to counteract the adverse balance of payments, to which the loss of gold and the threatened depreciation of the unit were due, by imposing a quantitative restriction of imports, and a system of exchange control calculated to prevent any purchases of foreign exchange or foreign assets except for strictly defined and limited purposes.

This second alternative, which was adopted by Germany, could in itself be no more than a partial remedy, since it left the export industries exposed to the unrelieved pressure of the fall of world prices. And it carried with it consequences so profoundly modifying the economic life of the world that we shall postpone the further consideration of it to a separate chapter (below, Chapter VIII).

The first alternative, the depreciation of the gold value of the currency unit, meant the abandonment of the criterion by which monetary policy had been guided under the gold standard, and a new criterion was imperatively required to take its place. The new criterion might take the form of a newly prescribed gold equivalent appropriately reduced from that which had previously prevailed. That course, involving a return to the gold standard at a lower gold parity, is what is called devaluation.

On the other hand, the new criterion might be entirely dissociated from a metallic standard and be based on some formulation of monetary policy defining conditions to which the value of the monetary unit should conform in the best economic interest of the country. Devaluation in any case disrupts the gold-standard tradition and dispels the illusion of the sanctity of the old gold parity. If the gold equivalent of the monetary unit can be altered once, it can be altered again. A gold equivalent chosen to suit the circumstances of a particular moment may become inappropriate or intolerable at a subsequent moment.

Thus, devaluation once admitted as a possible measure, some more fundamental criterion of the proper wealth value of the monetary unit than equivalence to a prescribed amount of gold is in any case called for. The desired criterion, with or without a gold standard, is to be found in some sense in *stability* of the wealth value of the unit.

Indeed the precious metals themselves were adopted as monetary standards primarily to secure stability of value. The fluctuations of the wealth value of the precious metals were long ago recognised, but were regarded as no more than a minor imperfection. Even in the nineteenth century the fluctuations in the wealth value of gold were, as we have seen, wide enough to give rise both to a serious unemployment problem and to disastrous financial crises. The fluctuations in the years 1919–39 were much greater, and their consequences were catastrophic.

CHAPTER VI

MONETARY POLICY

1. We saw in the last chapter that the method of regulating the wealth value of the monetary unit evolved in the nineteenth century was through variations of bank rate. But it cannot be assumed that bank rate is in all circumstances the best instrument to be used for the purpose, or even that it will invariably be effective.

When it is a question of checking a credit expansion, that is to say, of preventing an undue enlargement of the consumers' income, which would lower the wealth value of the unit, the short-term rate of interest can be raised to whatever level is required to produce a deterrent effect on borrowers. But the competence of the central bank to force up the market rate of short-term interest by raising the rate at which it will itself lend, depends on its power of compelling the other banks to borrow from it in order to supply themselves with currency. If there is a supply of currency available independently of that so acquired from the central bank, this power is impaired or destroyed. That may occur under a gold standard, when an inflow of gold more than offsets the withdrawals of currency that the central bank is able to effect. A redundant supply of gold in any case would call for a relaxation of credit, so that the failure of the central bank to make a high bank rate effective in such conditions is not to be counted as a defect in the system. But the Government may make an independent issue of paper currency outside the control of the central bank, or the central bank may be compelled to expand its own issues by lending to the Government. A rise of bank rate will have a deterrent effect on borrowers other than Government, but, if the Government's demands go beyond whatever compensating effect can be so obtained, the central bank is helpless. It is here that there lies that danger of inflation with which monetary theorists and the administrators who take guidance from them have always been so preoccupied. A remedy has to be sought in the financial operations of the Government itself. It must limit its expenditure and raise more money by taxation, or by loans genuinely subscribed from the resources of its own people, or by borrowing abroad.

But there is another weakness in bank rate as an instrument of credit regulation. When bank rate has been raised to a deterrent level, and a state of excessive activity successfully checked, reliance is placed on a reduction of the rate to stimulate activity and start revival. The high rate will have deterred traders from borrowing for the purpose of holding stocks of goods, and the resulting diminution in the orders given to producers will have caused the general falling off of economc

activity. When the rate is reduced, the pressure is relaxed, traders become readier to replenish their stocks and give earlier and larger orders.

Thereby activity should be revived. But we have seen how the falling off of activity may be seized by a vicious circle of depression. The decline of sales of goods leads traders to regard proportionally reduced stocks as appropriate. A trader who, when credit is at last relaxed, finds himself still holding stocks which he judges to be excessive in relation to his existing sales, will not be tempted by any rate of interest however low, or by any encouragement from his banker, to order more goods. If at such a moment the volume of stocks in the hands of traders generally is still excessive in relation to the volume of sales, the transition from dear to cheap money may fail to break the vicious circle.

There were in the nineteenth century times when business seemed to respond very slowly to the stimulus of a reduction of bank rate, and many months or even some years of cheap money were needed before revival could be clearly discerned. But on the whole statistical evidence goes to show that on those occasions some noticeable degree of revival did start in the early stages of cheap money, even though it made slow progress for a time.

The only instance when a depression can be said to have definitely passed beyond treatment by cheap money was in the years following 1929. The crises of 1931 supervened on a year of low bank rates in the principal centres. The return to cheap money in 1932 failed to stop the progress of depression. In the years 1933–6 the United States, Belgium, France, Switzerland and Holland successively found relief in abandoning the gold standard.

Bank rate is a delicate instrument, and is not appropriate for correcting a very wide disequilibrium. After a severe monetary dislocation it is advisable first to establish rates of exchange corresponding as closely as can be foreseen to the equilibrium value of the monetary unit, and then to use bank rate to give the finishing touches. The fixing of gold parity or of rates of exchange is the drive off the tee; bank rate is the putter used when the green is reached.

2. The experiences of the years 1919 to 1939 have given rise to a widespread dissatisfaction with bank rate, and attention has been directed more especially to the relation of Government finance to monetary policy. The inflation which raged in so many countries in the first three or four years of the period was obviously attributable to excessive Government expenditure being met by a creation of money, and the essential condition of stopping the inflation was clearly seen to be the limitation of Government expenditure to what could be met from legitimate sources. It was sometimes overlooked that this procedure, if a necessary, was not a sufficient condition of stopping inflation, for

even when a Government is raising a heavy surplus from taxation for the redemption of floating debt and the extinction of credit money, there may yet be processes at work to cause an excessive expansion of credit through trade borrowing.

When the plague of inflation gave place to that of chronic unemployment, attention was diverted from the redemption of floating debt as a means of escaping from inflation to an expansion of Government expenditure as a means of escaping from deflation. For that purpose there was needed some big non-recurrent category of expenditure extraneous to the ordinary budget, and capable of being brought to an end when the need for it had passed. Economists claimed to have found what was needed in a programme of public works, and it became the fashion to recommend this as *the* remedy for unemployment.

Sometimes there was no better reasoning behind the recommendation than the crude assumption that, if the Government employed more people, it must be increasing employment. But the more sophisticated economists quite understood that employment would only be increased if there were *an increased flow of money* in the shape of an expansion of the consumers' income and general demand.

According to one school of thought it should be the function of Government expenditure to intervene at the point where other methods of stimulating expansion fail. If the stimulus to be derived from cheap money has exhausted itself, and depression still persists, the Government, according to this view, can overcome the deadlock by setting money in motion. What it spends becomes additional income in the hands of those it employs, and so a source of additional demand. Additional demand draws upon traders' stocks of goods, and they give additional orders to manufacturers to replenish them. So, it is contended, activity spreads to the producers of consumable goods and throughout industry.

That is what has come to be known in America as 'priming the pump.' When the piston of a pump has been left dry and is insufficiently air-tight, the injection of a little water over it will start it working again, and similarly the Government expenditure is intended to start a revival of activity, which, once started, will continue of itself.

On the other hand, another school of thought assigns a more fundamental place to public works. Income generates demand, demand generates production, and production generates income. Income is applied by the recipients partly to consumption and partly to saving. Consumption is itself demand, but saving is not. Saving only generates demand in so far as it is accompanied by capital outlay. If capital outlay falls short of saving, to that extent income fails to generate demand, and there results a falling off of production and therefore of income. There is a failure of equilibrium, which corrects itself by a

decline of economic activity till the resulting shrinkage of incomes brings the volume of saving down to the level of capital outlay.

If that were a correct analysis of the causation of depression and unemployment, it would seem to follow that the remedy is to be found in an increase of capital outlay. And that is the part assigned to the programme of public works.

Now it is an observed fact that the instrumental industries, those concerned in capital outlay, undergo wider fluctuations as between times of activity and times of depression than those which produce consumable goods. But it would be unwarrantable to infer that the fluctuations in activity *originate* in the instrumental industries. For it is easy to see that a decline in economic activity, however caused, is likely to produce a more than proportional reduction in saving. The first impact of a decline in general demand is on profits, and, as we saw in Chapter II (pp. 37–8), profits are the principal source of saving. If capital outlay falls off at a time of depression, that is because the volume of saving from which resources are derived for it falls off.[1] Since a shrinkage of the flow of money is bound in any case to be accompanied by a shrinkage of capital outlay, the fact that they occur together cannot be adduced as evidence that the latter is the cause of the former, any more than it could be argued that the night causes the sunset because the sun abhors darkness.

The argument is sometimes put in another form. Depression arises from a deficiency of demand—an excess, that is, of the consumers' income over general demand. But general demand is composed of consumption and capital outlay, and saving is the excess of the consumers' income over consumption. Therefore an excess of the consumers' income over general demand is identically equal to an excess of saving over capital outlay. Deficiency of demand is therefore equal to excess of saving over capital outlay. But that tells us nothing at all of causes or of remedies. It is an identical proposition resulting from the meaning of terms.

Now it is quite true that capital outlay undertaken by the Government may conduce under appropriate conditions to an expansion of general demand. It must be *additional*, that is to say, must not, by using up the resources of the investment market, prevent or delay an equal amount of privately initiated capital outlay. It need not necessarily be financed by avowedly inflationary methods; if it merely sets in motion money held idle in balances for want of eligible investments, it will enlarge the flow of money.

But if exceptional measures to set idle money in motion are called for, that must be because a state of depression is already in being.

[1] Actually the decline of capital outlay may be less than that of saving, because the liquidation of working capital may provide an additional resource (see Chapter VII, p. 120).

Under conditions of normal activity money moves without difficulty; a fortuitous shortage of demand occurs every now and then, but is quickly corrected. A fortuitous shortage of demand might, it is true, develop by way of the vicious circle of credit contraction into a serious depression. But it is the business of the central bank to intervene whenever an undue tendency towards expansion or contraction of credit appears, and to apply the appropriate credit measures through bank rate and other means to correct the tendency. It is only when these corrective measures have *failed* that the opportunity occurs for a programme of Government expenditure on public works to set money in motion.

And advocates of the public works policy invariably assume that serious depressions *will* occur, and consequently that the programme of public works will be on a very large scale. A big programme cannot be started suddenly. It is a matter of many months, and probably a year or two before it can reach its full extent. No one would advocate as a credit measure a programme equivalent to a fraction of 1 per cent. of the national income to be put in operation for a month and then stopped.

3. Thus the policy presupposes that the plague of depression and unemployment has *not* been cured. It is in fact a mere palliative, to be defended only by scepticism of the efficacy of bank rate and its associated credit measures.

This scepticism is not supported by experience. Experience has somehow permitted central banks to believe that they are regulating credit and, through credit, money, when they raise and lower bank rate. So far as the scepticism claims to have any link with practical affairs, it usually points to the attitude of the individual trader, who undoubtedly is apt to regard the charge for interest on his short-term indebtedness as a very trifling part of his costs.

But it has already been pointed out (above, p. 83) that a trader can vary his temporary indebtedness at the cost of very trifling inconvenience by hastening and increasing or delaying and reducing his purchases of commodities. The slight cost of borrowing is balanced by a similarly slight convenience of holding stocks of goods. That is so whatever the original purpose of the borrowing, provided that he does hold stocks.

When all short-term borrowing is influenced in the same direction, the action of traders in increasing or decreasing their indebtedness takes effect in an increase or decrease of orders given to producers. And whereas a variation in the orders a retailer or merchant gives for a supply of goods to replenish his stock-in-trade is of slight concern to him, it is of serious and pressing concern to the producers who supply him.

It is the nervous system of the economic organism that is here

at work. There may be applied to a nerve a stimulus which by mechanical standards is minute, but the response of the nerve may yet bring the whole power of the muscular system into action.

The cost of temporary borrowing is slight because bank rate is not raised to any very high figure. When it gets up to 6 or 7 per cent., and overdrafts are charged 1 per cent. more, the cost of borrowing, even for no more than a month or two, is not absolutely negligible. But central banks have been accustomed to count on more moderate rates, 4 per cent. or less, having their due effect, and have made changes of one-half per cent. at a time. If they have relied on apparently trifling adjustments to restrain an excess of activity or to stimulate recovery, that is not because the credit system in which the world has trusted for a century is an imposture, but because it has worked so smoothly that a small rise or fall of bank rate serves as a signal to banks and traders, and accomplishes a result which, had they been less sensitive, would have required relatively wide movements. And even though the central bank, in its capacity as lender of last resort, may never refuse to lend to eligible borrowers, the commercial banks exercise their discretion in refusing to lend or curtailing the amounts lent to their customers. When bank rate is put up, the banks foresee a policy directed to credit restriction, and forthwith put pressure on their customers to do with smaller advances than they ask. When bank rate is reduced, this restrictive pressure attendant on dear money is relaxed.

The moderate movements of bank rate which are usual are the result of experience. Had they been found ineffective, higher rates and wider movements would have been resorted to. Had 6 or 7 per cent. failed to check expansion, 10 per cent. might have been imposed, and 10 per cent. need not have been the limit. A rate of 10 per cent. or more is a milder measure than an absolute refusal to lend.

The hostility to the use of bank rate which is expressed from time to time among traders arises not from doubt as to its efficacy as an instrument for the regulation of credit, but, on the contrary, from a fear of its deflationary power. And of course the deflationary power, unless judiciously applied, is a serious danger. When dear money is continued too long as in 1920–1 and 1929–30, or is imposed at a time of unemployment as in 1925 and 1931, the effects are disastrous. But these vagaries were an innovation and a conspicuous departure from the practice of the period from 1844 to 1914, when bank rate was smoothly and successfully operated.[1]

The deflationary power of bank rate is great, and it should only be applied when it is definitely needed to prevent an undue credit expansion. The moment a high bank rate has done its work, and the

[1] See my *A Century of Bank Rate*, pp. 133–4, 143–5 and 242–3.

danger of expansion is past, the pressure should be relaxed. There need never be any deflation at all, except in so far as the mere checking of expansion will for a moment produce some of its symptoms.

In the existing organisation of money and credit, regulation by bank rate cannot be dispensed with. Government expenditure on public works, whatever its merits as a device for 'priming the pump' or relieving an exceptionally deep depression, offers no means of checking an undue monetary expansion. The essential condition of avoiding deflation is to avoid inflation. The various expedients that have been devised for checking inflation, the extinction of redundant credit by sales of securities or by borrowing operations on the part of the central bank, raising statutory reserve proportions of commercial banks, maintaining parity of the monetary unit in the foreign exchange market, are all liable to be defeated by an excessive expansion of credit, and require some means of directly preventing such an expansion. The cash basis on which the banking system erects the credit structure is composed of the notes and deposit liabilities of the central bank, which are created by its lending operations. It is by regulating those lending operations that the cash basis, and through it the credit structure, can be controlled.

As we have seen (above, pp. 92–3) there are circumstances in which bank rate fails to give control of the situation. Against inflationary Government finance there is no absolute safeguard. The gold standard affords a first line of defence, and that was one of the grounds for the almost superstitious adherence of the nineteenth century to the gold standard. Nevertheless the gold standard was apt to be summarily abandoned in case of pressure in an emergency.

4. In drawing guidance from the experience of the nineteenth century we should not forget that the gold standard was itself a powerful support to the bank rate policy. The inflow or outflow of gold, which gave the signal for a relaxation or restriction of credit, was itself a gain or loss of currency. And, what was more fundamental, the value of the currency unit of any country was linked to the currency units of all the rest; it was linked in fact to a standard which had the inertia characteristic of a world organisation. If people are aware that the monetary policy of a country is directed to a definite standard and are confident that the unit will never deviate far from that standard, speculative movements assist the monetary authorities, over short periods, to adhere to it. Under nineteenth-century conditions, if the foreign exchange value of pounds, francs, dollars or marks fell to the gold export point, traders would be prompted by the general assumption that the drop was a temporary one to hasten their purchases and delay their sales of the currency in question.

If the future monetary systems of the world were to dispense with gold, this advantage would be given up. A currency unit unsupported

by any metallic standard may be regulated by reference to some criterion of stability of value. But it would hardly be possible to find an intangible standard of such delicacy and precision as to confine the outlook of speculators to fractional differences no greater than those corresponding to the gold import and export points of the foreign exchange market.

In practice it is impossible to regulate the monetary system of a country without direct reference to the foreign exchanges. A brief description of the manner of working of the foreign exchange market therefore will not be out of place.

'Foreign exchange' or simply 'exchange' means rights to money, especially in the form of bank credit, in another country. Such rights are embodied in bills of exchange, cheques or drafts, by means of which they can be assigned from one person to another. Or a bank, when it sells exchange to a customer, may send a message (telegraphic transfer or mail transfer) to a branch bank or correspondent bank in another centre, instructing it to hold a stated sum at the customer's disposal. The market deals in rights to money and not in tangible currency in the form of coin or bank notes, because in general the currency of one country does not circulate in another. The provision of currency for travellers is quite a subsidiary business. Where two countries both have a gold standard, the transport of gold from one to the other becomes the function of specialised bullion dealers.

The foreign exchange market offers rights to money in any place in exchange for rights to money in any other place, and it quotes a price in the form of an arithmetical relation between the monetary units in the two places. That is the *rate of exchange*, expressing the market value of each unit in terms of the other.

Money in London is reckoned in pounds, and money in New York in dollars, and, if the rate of exchange is \$4 to £1, that means that money in either centre can be exchanged through the market at that rate. For example, a man in New York can buy £1,000 in London at a price of \$4000. (In practice there are a buying rate and a selling rate, the difference between them providing the equivalent of a commission to the dealer.)

Any one who acquires money in a foreign country, whether for goods sold, or for services rendered, or by raising capital, or from interest or dividends or repayment of investments that he has previously made, is likely to want to exchange the money for money in his own country. The dealers in the market (who are for the most part banks) give facilities for doing this. Every dealer must have some kind of agency in the centres with which he undertakes to do business. A bank may have branches in some distant centres; in others it establishes relations with other banks which are willing to act as its 'correspondents.' When a customer has money at a foreign centre

and wants to sell it, the bank will receive the money to the credit of its own account with a correspondent bank at the foreign centre, and will credit the customer with the equivalent at home. And when a customer needs money at the foreign centre, the bank will draw on its account with the correspondent bank by means of a cheque or transfer or bill of exchange in the customer's favour, and debit the customer with the equivalent.

Banks dealing in foreign exchange are in general unwilling to assume what is called an ' open position ' in any currency unit other than their own. That is to say, they aim at ' keeping their books even,' their assets in any foreign unit being just offset by equivalent liabilities in the same unit. They eschew speculation, and consequently so far as they, the dealers, are concerned, the market is not equipped to correct any momentary discrepancy between the demand for exchange on any country and the supply.

When the gold standard was in operation, the necessary corrective was supplied by gold movements. Any foreign exchange dealer could withdraw a superfluous balance from a foreign centre by buying gold with it and bringing the gold home, or could make good a deficiency of funds at a foreign centre by sending gold thither. But when there is no international metallic standard, the corrective has to be looked for in changes in rates of exchange calculated to induce people to hold either more or less of a currency, as the case may require. The appeal is to speculators, not exclusively to speculators in the strict sense who enter into forward transactions with a view to making a gain by reversing them, but also to traders who regularly receive and make payments and hold balances in more than one country. These traders assume open positions in foreign exchange as an ordinary incident of their business, and will be alive to the possibility of avoiding losses or making gains by hastening or delaying purchases or sales of foreign currencies.

But there is no certainty that speculators will intervene promptly to correct a momentary discrepancy between purchases and sales of a currency. And, even if speculators do intervene there is no certainty that they will not widen the discrepancy instead of narrowing it. A fall in the value of anything often leads speculators to anticipate a further fall; a rise to anticipate a further rise. In the particular case of a speculation in foreign exchange there is the added danger that speculation for a fall of any currency unit is likely to lead to a creation of credit in terms of that unit and so to enlarge the supply of it.

For example a trader who postpones his sales or hastens his purchases of foreign exchange weakens his cash position at home. Either he carries on with a smaller balance, thus increasing the supply of money actively circulating, or he obtains an advance from his banker, and occasions an expansion of bank credit.

When a speculator effects a forward purchase of foreign exchange, and no money passes till the future transaction matures, the effect is not so apparent. Nevertheless in that case the purchase of foreign exchange will be made directly or indirectly from a bank which does not itself speculate, and the bank will cover its forward sale of foreign exchange by an immediate or 'spot' purchase. Consequently extensive speculative forward purchases of foreign exchange lead to an increase in the assets of the banks by the amount of foreign exchange they buy to cover themselves, and to this increase in bank assets corresponds an equivalent increase in bank liabilities, and expansion of bank credit. The credit created brings an additional supply of the country's currency into existence, and the action of the speculators tends to bring the fulfilment of their own expectations. Therefore, unless the monetary authorities are themselves prepared to intervene in the foreign exchange market, there is an ever-recurrent risk of the whole monetary system getting out of control. Their intervention takes the form of buying foreign exchange if their own currency unit tends to rise too high, and of selling foreign exchange if the unit tends to fall too low.

This is no more than convertibility of the low currency into foreign exchange, the counterpart of the convertibility into gold which is the foundation of the gold standard. After the collapse of the gold standard in 1931 it was found necessary to establish exchange funds, such as the British Exchange Equalisation Account which was set up in 1932, to perform this function, in order to relieve the foreign exchange market of uncovered balances when speculative operations failed to absorb them or could only be induced to do so by an undesirably wide concession in rates of exchange.

The gold market survived, though without fixed parities, and it is because dealings have to be at a variable market price, involving risks of loss which a central bank cannot afford to incur, that a Government fund has superseded the central bank's gold reserve.

In effect the United States has been employing a gold standard ever since 1934, when power was taken to fix the gold equivalent of the dollar administratively, and the rate of $35 to a fine ounce then fixed has remained unchanged. Since exchange control was instituted in the United Kingdom on the outbreak of war in September, 1939, the pound sterling has been held at the official rate of $4.03 (subject to a temporary lapse in 1940 in the 'free' New York market, which worked outside the control). Here is the semblance of an international gold standard, but it is impossible to say how it will develop when the emergency conditions in which it has come into being are no longer the same.

Even without a metallic standard monetary policy may aim at fixed rates of exchange. For example, when Great Britain departed

from the gold standard, she carried a number of countries with her forming a 'sterling area.' They maintained the convertibility of their money into British pounds sterling, and held sterling reserves in London in the form not of gold but of bank credit and securities.

That system, however, requires some principle by which the wealth value of the currency units of the entire group is to be regulated. And if the system of linking units together is anything less than worldwide, the need of intervening in the foreign exchange market to regulate the rates between one group and another remains. The significance of the rates of exchange in any country depends upon the policy by which the monetary units of other countries are regulated. When one country modifies the rates of exchange on the rest in order to attain monetary equilibrium, it relies on the inertia of a world system of independent monetary units to furnish a fixed standard, a fulcrum for its lever. If the world system contained an indefinitely large number of units, and any one country contained no more than a very small part of the economic resources of the whole, this assumption might be realised. But the number of independent states in the world is limited, and among them the number of *independent* currency systems is more limited still. The smaller, poorer or less developed countries link their monetary systems to the great financial centres in those of the more economically advanced countries with which they have the closest connexion. The groups so formed are not fixed either in composition or in number, but under the conditions of the modern world there are not likely to be more than half a dozen of any importance.

For the purpose of fixing rates of exchange, each group within which currency units are linked to a single centre must be regarded as a unit, and the characteristics of a concourse of atoms conforming to the laws of large numbers are lost. The groups may be found to be working at cross purposes, each relying on the stability of the rest when all are in movement. Or at one and the same moment each of two groups might even be trying to lower the value of its currency unit relatively to that of the other.

In such a system it is essential that somewhere there should be an independent standard of stability. The gold standard supplied this need but imperfectly. In its place either each currency group must aim independently at stability of the wealth value of its own unit, or there must be international co-operation for the purpose. That is a subject to which we shall return (see Chapter XV, pp. 236–9).

CHAPTER VII

ACCUMULATION

1. We have taken the subject-matter of economics to be *work*. The subject-matter is more usually defined as *wealth*. Wealth is too narrow a concept, being limited to things marketable or at any rate capable of valuation by reference to markets. It fails to embrace an economic system which dispenses with markets. For competitivism, however, the two definitions are co-extensive. Work is the activity that makes wealth.

The term 'wealth' has two meanings. For it is sometimes limited to tangible things having a market value, whereas, if it is true that the product of work is always wealth, wealth must include services rendered direct by one person to another such, for example, as teaching, advice, domestic service or entertainment, which are not embodied in any tangible object.

It is wealth in the former or narrow sense, confined to tangible things, which is susceptible of accumulation. It is only in virtue of accumulated wealth in tangible form that a community can attain anything better than extremely primitive conditions of material welfare. We might almost say that by a 'rich' or 'wealthy' community we mean one with great material possessions in tangible form. That would in reality be going too far. For the aptitudes of the people for using their material possessions are an indispensable constituent of their wealth in this collective sense.

All the same, accumulation is one of the fundamentals of economic activity. It is more fundamental than the idea of wealth itself, since there may be accumulation of material objects capable of satisfying needs or conducing to welfare in a community in which the exchange of goods is not practised and market value has no meaning.

We must approach the subject, however, through competitivism. Competitivism leaves the individual free to employ his income as he pleases. He may spend on immediate consumption, or on accumulating wealth in his own hands, or on acquiring valuable rights against others who are in a position to secure him a future return.

In Chapter V we found the consumers' outlay to be composed of consumption and investment. Investment we analysed into purchases of income-yielding property (instruments of consumption) and purchases of securities. Any excess of a consumer's income over his outlay remains in his hands as money. Under modern conditions money itself takes the form mainly of bank credit, against which the banks hold assets.

The assets held by banks consist principally of pecuniary rights,

either advances to traders and other customers, or securities acquired, like those of the individual investor, through the investment market. In the nineteenth century a considerable part of the money composing the unspent margin was gold or silver coin, and gold survives as an object of accumulation in the reserves of central banks and Governments. In recent years its accumulation in private hoards has revived, though it is no longer made available in coined form.

The money placed in the investment market becomes available for the formation of traders' capital. Traders' capital is composed of instrumental capital and working capital. The instruments of which the former consists are to be understood in a broad sense to include anything which is used for the purposes of economic activity and which is not physically diminished thereby otherwise than by wear. Thus they comprise not only tools, machines and appliances, but buildings and structures, such as factories, shops, offices, theatres, warehouses, etc. Working capital includes goods in process and goods held in stock, whether finished goods awaiting transport or sale, or materials or intermediate products awaiting further process.

An instrument remains complete in all its parts through repeated uses, while working capital is only used once in the stage of production to which it belongs. The materials of industry when used are used up, that is to say, either destroyed like fuel which is consumed, or transformed into something else, as cotton is spun into yarn and yarn is woven into cloth.

Referring in Chapter V to consumers' capital, we found it convenient so to define it as to limit the objects of investment and capital outlay to real property, such as houses and gardens. Everything else, furniture, vehicles, utensils, clothing, appliances for personal use, ornaments, works of art, along with consumable food and materials, we shall regard as taken into consumption when acquired by the consumer. That means that they are excluded from accumulation. Undeniably the stocks of such things in consumers' hands are a part of accumulated wealth. But if we treated the many miscellaneous and minor instruments of consumption as objects of accumulation, we should have to attribute to each a hypothetical rental value composed of interest on its first cost and an appropriate depreciation allowance calculated to replace it when past use. That would sometimes not be inappropriate to a yacht or a car, but applied to a chair or a handkerchief or a tea-pot becomes an absurdity. And increased purchases of these things usually mean not that the accumulation of wealth is so much the greater, but that the purchasers have been discarding their existing possessions earlier, and the shortening of the lives of these possessions (implying of course increased depreciation allowances) represents increased consumption rather than increased accumulation.

Accumulation, if it excludes all movable wealth in the hands of

consumers, will be composed of the increment of traders' instrumental and working capital and of consumers' fixed capital. The increment of traders' instrumental capital and consumers' fixed capital will be a net amount arrived at by deducting depreciation from capital outlay. The increment of traders' working capital may be either positive or negative; that is to say, instead of an increase to be added there may be a decrease to be subtracted.

The amount of wealth accumulated in any interval of time is necessarily equal to the amount of saving in that interval.

Saving consists in the excess of incomes over consumption, and if incomes are equal to wealth produced, saving is equal to the excess of wealth produced over consumption, that is to say, to wealth accumulated. Nor does this result depend on our definition making the consumers' income equal to wealth produced, by excluding non-productive incomes derived from national debt interest, social service benefits, charity, etc. Even if the non-productive incomes were added in, the payments made by taxation and charity to provide them would have to be deducted, like expenditure on consumption, to arrive at the savings of those who bear the burden.

In providing the most considerable part of these non-productive incomes, the Government acts as an intermediary. It raises money by taxes and pays it away, partly for services rendered (for intangible wealth such as administration, law and order, defence, etc.), and partly for the non-productive incomes. But the Government itself will not maintain an exact balance of revenue and expenditure. When it meets part of its current expenditure by borrowing, this current expenditure counts as consumption, and the borrowing has to be subtracted in computing the net amount of saving in the community. When the Government realises a surplus, or provides a sinking fund that is additional saving.

On the other hand, when the Government undertakes capital outlay, so that its expenditure bears fruit in the existence of capital assets, it is itself accumulating. If it raises money for such outlay from the investment market, the indebtedness incurred does not represent a deduction from saving, and, if the capital outlay is met out of revenue, it is additional saving, like a sinking fund. That applies even to public works which yield no revenue to the Government, provided they yield a sufficient value in their use to justify the expenditure incurred in first cost and upkeep. When the Government spends money without creating any lasting asset, or in excess of the properly assessed value of any lasting asset, it is 'consuming' and money raised for the purpose by borrowing is negative saving or 'dissaving.'

2. We saw in Chapter VI (p. 80) that it is the function of the investment market to equalise net capital outlay and the amount made available from savings for it, but that this equalisation cannot

be effected instantaneously and precisely, because capital outlay is an operation which requires previous planning and takes time to carry into execution. In the interval, when there is an excess or deficiency of capital outlay, the difference is made up by an increase or decrease of bank advances either to dealers, investors or speculators in the investment market or to the traders incurring the capital outlay.

The existence of this difference is not inconsistent with the principle that accumulation is equal to saving, because the excess or deficiency of capital outlay is compensated by an equivalent decrement or increment of traders' working capital. For if saving is insufficient, that means that consumption is in excess, and so much of consumption as is not met from production must be met from stocks of goods, that is to say, from working capital. And if saving is excessive that means that consumption falls short, and there is a deficiency of disposals and an increase of unsold stocks of goods.

A brief digression to explain the working of the investment market will not be out of place. The central organisation of the market is a stock exchange, where securities are bought and sold. It enables the investor to acquire a security, promising him an annual income in the form of interest or dividends, at a competitive price, and, should he so desire, to resell it at a future time likewise at a competitive price. Herein are two substantial advantages: in the first place the price, being competitive, may be assumed to represent as fair an estimate of the prospects as can be made at the time; secondly the power of resale confers a certain degree of liquidity on the investment (subject always to the risk of some capital loss in the price of resale).

A stock exchange is organised through a body of brokers and dealers. The brokers act as agents for anyone outside the market who seeks to buy or sell. In the London Stock Exchange the organisation includes dealers ('jobbers') in whom the buying and selling is centralised, and who are precluded from acting as brokers. The brokers bring the transactions entrusted to them to the jobbers, and it is the jobber's function to quote a price at which he is willing to deal. A broker who is dissatisfied with the price quoted is free to approach another jobber, so the prices are competitive.

This system puts upon the jobber the speculator's function of anticipating market conditions. He cannot afford to wait till an excess of purchases or sales by the outside public calls for a rise or fall of the prices he quotes, for that would be to invite a loss every time conditions change.

In the New York Stock Exchange in Wall Street the market is an organisation of brokers who frequently combine business on their own account with the agency business proper to a broker, but do not assume anything quite like the London jobber's responsibility for making a price.

The stockbroker in London and New York takes upon himself not only the business of finding sellers to match the buyers and buyers to match the sellers, but also that of advancing money to buy securities, when the buyers are speculators who prefer to postpone closing their transactions, and the brokers have to accept delivery of what their clients have bought. To provide funds for the purpose, the brokers obtain bank advances. So arise the brokers' loans which have played so prominent a part in the financial history of New York, and the account to account loans familiar, though less conspicuous, in the banking world of the City of London.

Speculators may choose to accept delivery of securities they intend to resell and themselves obtain bank advances to pay for them, and speculative investors obtain bank advances in order to buy securities at what they judge to be a favourable moment, with the intention of retaining them and paying off the advances out of future savings. Speculators include not only those who make an occasional incursion into the market when they hear of an opportunity of gain, but concerns such as investment companies which make a regular business of dealing in securities for the sake of profit on buying and selling, and who though not themselves part of the market organisation are to be counted as traders in it.

The bank advances raised in this way are required to supplement the cash resources of the borrowers. The money, derived from cash balances and bank advances together, which is applied to the purchase of securities, constitutes an extraneous resource of the investment market, supplementing the inflow of savings. When money derived from sales of securities is used to repay advances or retained in balances, this extraneous resource is diminished; it may become a negative quantity, reducing, or in extreme cases for a time more than offsetting, the inflow of savings.

3. The Stock Exchange is a very essential part of the investment market, but still only a part. Its function is to provide the channel for the purchases and sales of existing securities, and in the process to make prices which set the standard for the long-term rate of interest. Another essential part of the market is the organisation for creating and marketing new securities, that is to say, for bringing out new capital issues or flotations.

In the highly organised markets of London and New York this operation has devolved on specialised agencies called issuing houses or investment bankers. They provide the promoter who wishes to place a new security on sale in order to raise capital with the means of access to buyers and with arrangements to ensure that so much of the issue as is not in the first instance subscribed for will be taken up for the time being by people possessing the necessary funds. These latter are the 'underwriters,' who in return for a commission undertake each

to take and pay for an agreed proportion of such part of the issue as is not otherwise disposed of. Sometimes instead of assuming the responsibility for any unsold residue they will agree between them to take the whole issue, with a view to reselling their holdings as the state of the market may permit, counting on a profit on resale instead of a commission.

Whatever the nature of the contract, the connexion of an issuing house with a collection of men of substance, through whom arrangements can be made for ensuring that an issue will be taken in full, is the foundation of its business. In order to retain that connexion, it must avoid overstraining the market. If the issuing house commits itself to a flotation which is unpopular or is distrusted, or to a flotation at too high a price, or to a flotation in a market which is already glutted, a great part will have to be taken by the underwriters. They may be unable to dispose of the securities they have acquired without loss, and till they have got rid of them, they will not be free to take new business. Some of them may even lose confidence in the issuing house, and desert it for a rival. Issuing houses therefore have to be careful as to the business they take, and when the market becomes unfavourable, they either deter promoters by insisting on very exacting terms of issue, or reject proposals outright.

It is only for the big flotations requiring an appeal for public subscriptions that the interposition of an issuing house is necessary. Smaller ventures are undertaken by traders either with their own means or in association with a limited number of individuals with whom they have personal contact. A business started on a moderate scale can, if it prospers, build up reserves by reinvesting undistributed profits. These reserves can be drawn on from time to time, and supplemented by borrowing, for extensions of capacity. If eventually the growth of the business requires capital resources beyond what can be supplied in this way, it may be reconstructed as a public company with a public issue of shares. That will give the original participants the opportunity of capitalising their prospective profits. The services of an issuing house are invoked partly for issues of that character, partly for issues by Governments or public authorities, which are apt to be on a larger scale than those of trading companies, and partly for issues, such as those of public utility or transport undertakings, which require a larger capital than can be raised privately from the beginning of their operations.

Thus the issuing houses have to be in a position to handle very large sums of money. Each flotation is a heavy and responsible piece of work, and any concern which gets enough of the business to assure an approximate continuity, and to give it the experience which gains the confidence of promoters, must be working on a large scale. There can in fact only be few regular issuing houses, and each must be the

owner of big resources. Being few, they can readily make their rejection of business effective.

Away from the great financial centres the investment market is not characterised by so much specialisation. A stockbroker who lends money to purchasers of securities may equally hold money to the credit of sellers, and become hardly distinguishable from a banker. Bankers may adapt their organisation to do the work of issuing houses, and may at the same time act as underwriters or participators.

This large scale financial business is a branch of profit-making. It is often attacked as yielding excessive profits to its practitioners, particularly to those who participate in a syndicate which takes the whole of an issue at an agreed price, and resells it for whatever the market will pay. In those instances where in the end hopes are disappointed, and investors who have bought from the original syndicate lose a great part of their money, the agency which put the issue on the market is perhaps subjected to blame and recrimination. But that is a misconception of the system. An issuing house is concerned not with the real merits of the enterprise which is raising capital, but simply with the prospect of placing the shares. The promoters who are responsible for the enterprise are under a binding obligation, legal as well as moral, not to deceive the public, and the partners or directors of the issuing house are equally bound not to connive at any deception. But there is no obligation on these latter to exercise their own judgment on the available evidence as to the ultimate prospects of the enterprise. It is the promoters who are or ought to be experts on that matter. The expert judgment of the issuing house is limited to the sphere of finance, and it can only criticise the enterprise itself from the point of view of the prudent investor claiming no technical knowledge. When promoters seek to sell the shares, and investors are eager to buy, it is no business of a mere intermediary to warn the latter against the transactions which it is his special function to facilitate. The issuing house must, no doubt, advise the terms on which securities are to be offered for sale, but the advice desired is merely whether they can be sold on those terms. Whether the subscribers who buy them will be wise or the reverse is a different and irrelevant question. The only qualification to which this principle is subject is that the reception of an issue of securities among investors depends not on mere baseless fancies and imaginings, but on the investor's judgment, often shrewd and well balanced, as to the real prospects, and the advice of the issuing house, if it is to command the confidence of promoters and underwriters, must take the views of the wise investors as well as of the foolish into consideration.

4. Competitivism asks a great deal from human nature when it entrusts the task of equipping the community with capital to the free choice of the market. So long as markets are concerned only with

meeting the needs of the moment, the way of competitivism is smooth enough. Consumers buy what they choose, retail and wholesale dealers order fresh supplies to replace what they sell, producers busy themselves with providing supplies in response to the orders. Production of each commodity is nicely adjusted to demand, provided the demand for the product of any industry does not outrun its productive capacity. The first symptoms of demand exceeding capacity are a delay in executing orders and a rise of price. Each producer has then to judge whether it is worth while to extend the capacity of his own undertaking. If the enlarged demand is permanent, it is sure to attract an increase of capacity, and those who make the necessary extensions first will be the gainers. When output is so far expanded as to meet the demand at the former price, there is no longer room for further extensions of capacity. Those producers who seized the favourable opportunity will have secured for themselves additional business yielding additional income at the normal rate of profit.

It is even worth while to provide reserve capacity in excess of the demand anticipated in the near future, at any rate for a product the demand for which might reasonably be expected to grow, and it is usual for any industry to have some surplus capacity available.

The extension of capacity to meet demand is only a part of the capital outlay which traders incur. If extensions of capacity with an unvarying amount of capital for each unit of output were the only opening for capital outlay, the demand for capital outlay would be limited to so much as would equip the additional population coming into employment. If that failed to use up current savings, the excess saving would represent income which failed to generate demand. A disequilibrium would be felt in a deficiency of demand, an accumulation of unsold goods and a falling off of activity. Equilibrium would be restored only when the resulting shrinkage of savings overtook the shrinkage of capital outlay.

What gives the system the essential flexibility needed to avoid this pitfall is the circumstance that the amount of instrumental equipment employed for each unit of output *can be varied*. Any trader who sets out to produce a commodity for sale seeks to reduce his costs to a minimum. He can instal various labour-saving instruments, but the further he goes in doing so, the greater will be his capital outlay. He cannot afford to start his business less efficiently equipped than those of his competitors. The industry as a whole will have attained a standard of labour-saving equipment which (apart from innovations in course of adoption) will be approximately uniform.

This standard should theoretically extend to all instruments of which the labour-saving capacity exceeds their cost. For that comparison the cost of the instrument must be expressed in current form as an item in the cost of output. The first cost must be spread over

the whole life of the instrument, so that every unit of its output has its duly apportioned share. That is the depreciation allowance, to which must be added the cost of maintenance, and also *interest*.

Interest is the remuneration which the investment market enables the investor to obtain for himself. It is or should be determined by the market competitively. Economic theory teaches that the rate of interest ruling at any moment limits the amount of capital outlay to what the resources of the market can provide for, by making unprofitable all objects of capital outlay which do not give the prospect of a sufficient labour-saving capacity to cover interest on their first cost as well as maintenance and depreciation. If that were rigorously true, it would follow that the market can at will reduce the demands made upon it by raising the rate of interest. And if there were no *new* kinds of labour-saving instruments being discovered and made available, there would, according to the theory, be a progressive reduction of the rate of interest, gradually making remunerative those instruments which at a higher rate would have failed to cover their costs. Of the potentially possible aggregate of labour-saving instruments new layers would be successively brought into production as the rate fell, and the market would thus maintain capital outlay at whatever level equilibrium might require. Invention, however, is continually adding to this potential aggregate of labour-saving instruments, and those newly discovered may have a yield in cost-saving capacity far in excess of what is called the marginal yield, that is to say, the yield of the layer corresponding to the current rate of interest. In virtue of their high yield, these innovations will be given the preference over the marginal instruments, and the progressive fall of the rate of interest will be retarded and possibly even reversed.

This theory does in a way represent the underlying forces at work in the investment market. But in the process of practical application it becomes so distorted as sometimes to be almost unrecognisable. Calculations of yield are made in a rough and ready manner; even when the calculations are based on experience, they depend on assumptions as to the length of life of the instrument, the intensity of its employment, the apportionment of overhead expenses, and other estimated items. And, when an estimate of the labour-saving capacity of an instrument previously untried has to be made, the uncertainties are greater still.

There is no clear dividing line between instruments which are potentially available and already known to be technically possible, but which have not been tried because the rate of interest has been too high, and those which are new discoveries. All untried instruments are innovations, and those which have only been put into practical use long after they have been shown to be technically possible may after all be found to be highly profitable.

The trader treats the adoption of a previously untried instrument on the same footing as a new enterprise. He looks for a net yield substantially in excess of bare interest, not only to compensate for the risk involved in an experiment, but to provide him with a profit.

Moreover innovations in an industry are subject to something of the same kind of resistance as price-cutting and competitive publicity. When all is working smoothly, it is not to the interest of those engaged in the industry that changes should be made in their plant and processes. If one of them starts an innovation by installing some appliance not previously used, and the experiment is found to succeed, so that his costs are diminished, the others will be compelled by the force of competition to follow his example. And, when they have done so, he will find himself after all with no permanent advantage. The gain realised during the interval while his competitors are adopting the innovation may be considerable enough to reward him for his venture, but the greater the immediate gain the shorter will be the interval. If all those engaged in the industry are aware of the possibilities of the innovation, it may be that as soon as one starts all will take the plunge together, and none will reap exceptional profits. In face of so unattractive a prospect all may be restrained by a tacit accord, till they are threatened with the intrusion of new-comers prepared to take advantage of the new methods.

Once the experimental stage is past, and the new type of instrument is generally adopted in the industry, it becomes a recognised item in costs. Its cost-saving capacity is reflected in a reduction of the price of the product, so that producers once again get no more than a normal profit. The cost of using the instrument is reckoned at maintenance, depreciation and interest, though this may fall far short of its real yield in terms of labour-saving.

To find instruments of marginal yield, we must look for them not among innovations but among those instruments of kinds already in use, which only pay for themselves in favourable conditions. It may be only just worth while to use such an instrument, for example, because there are physical obstacles interfering with its normal usefulness, or because it is only intermittently employed. Or again there will be cases where an instrument with a yield far above the margin can yet be given a slightly increased cost-saving capacity by some addition to its first cost improving its durability or its efficiency, and it may be thought worth while to carry this process as near as may be to the margin.

But after all marginal instruments are likely to form a very unimportant class. The generality of instruments, those awaiting adoption as well as those already adopted, will have yields far above the margin.

5. In the traders' capital outlay we may distinguish what may be called the 'widening' of capital, that is to say, the capital outlay intended

to extend productive capacity with the existing standard of instrumental capital for each unit of output, from the 'deepening' of capital, in the shape of capital outlay which substitutes instruments for labour,[1] and so increases the amount of instrumental capital for each unit of output. There are innovations which save both capital and labour, and, to take account of these, it is better to define widening and deepening in relation to labour rather than in relation to output. Widening occurs when there is an extension of capacity without any alteration in the amount of capital outlay required to equip a given amount of labour, deepening when the amount of capital outlay to equip a given amount of labour is increased. It follows that an innovation which saves both labour and capital is a deepening if it saves labour in a greater proportion than capital, while it is a negative deepening or undeepening if it saves capital in a greater proportion than labour.[2]

Whenever labour is saved for a given output, the labour released becomes available for additional output in the same or other industries and a measure of widening is called for to equip the labour so released with plant.

There is another way in which the amount of capital employed in proportion to the working population may be varied. Some industries use more capital in proportion to numbers employed than others. We may call the former 'thicker' industries, the latter 'thinner.' If for any reason in the course of widening the thicker industries expand relatively to the thinner, the amount of capital used in industry as a whole is increased in proportion to the numbers employed, in the contrary case it is decreased. We may call these processes a thickening and a thinning of capital respectively.

When an excess of capital outlay is pressing on the investment market, and the prices of securities fall, so that the long-term rate of interest is higher, there will be very little outlay on marginal instruments to be abandoned, perhaps none at all. But the rise in the rate of interest may still have a deterrent effect, for it may bring about a *postponement* of the raising of capital. A trader who has been counting on raising capital through a debenture issue at 4 per cent., and finds that owing to a temporary stringency in the investment market, the issue will have to be brought out at 98 instead of at 100, may prefer to wait, say, six months. He can reckon that, if he brings it out at once in spite of the unfavourable market, he will be in the same position as if he were raising a temporary loan at a cost of an extra 2 per cent. for six months or 4 per cent. per annum, making 8 per cent. in all, a rate high enough to make a serious inroad on his prospective profit calculated

[1] 'Labour' here means labour employed directly on the output. The cost of the instrument itself of course includes labour applied to producing and maintaining the instrument.

[2] See my *Capital and Employment*, pp. 36 and 319.

for that period. If he can obtain a bank advance for six months at a lower rate, he may start his project at once in spite of the postponement of the raising of capital, but if, as is not unlikely in the conditions assumed, the short-term rate of interest were correspondingly high, that would be no gain.

In practice the investment market does not rely solely on a high rate of interest as a deterrent; it puts direct pressure on promoters to postpone, curtail or abandon flotations. A very large part of traders' capital outlay, however, is paid for out of reinvested profits, and is not exposed to the pressure which the issuing houses can put upon new flotations. All the same any important capital extension or renewal that is being financed from reinvested profits will require the accumulations of several years, and that will mean either a sale of securities in which the reinvested profits have been placed by way of a reserve, or temporary borrowing in anticipation of future profits. The deterrent effect of the rate of interest will therefore be operative, though it will not be associated with any more direct pressure.

An industry may be so thick with capital that interest is an appreciable part of cost, and a rise or fall in the rate of interest affects the price charged to the consumer. That is so in the case of railways and public utilities, but still more in the case of housing. Indeed, when a house is let to a tenant the only costs to be covered by the rent are interest, depreciation and maintenance. Even if there is a substantial margin of profit for the lessor, interest still forms a considerable part of what the tenant pays.

The market in houses and other forms of real property is separate from the market in securities, but the two are closely linked together, in that they both tend to work up to the same rate of interest. As alternative fields of investment they are in competition with one another. If, as sometimes happens, industry is not sufficiently responsive to a favourable investment market, a very low long-term rate of interest, being reflected in house rents, may so stimulate the demand for houses as to bring a perceptible thickening of capital, that is to say, a diversion of capital outlay into housing and other thick industries.

Thus private enterprise, in so far as competitivism relies on it to provide capital outlay, works through several channels. The first cut off the joint goes to the widening of capital, for the trader who is presented with an opportunity for selling an increased output and securing a proportional increase in the income he derives from profits, is not easily deterred from installing the necessary additional capital equipment. Often he can find the requisite funds from his own reinvested profits, but, even if that source is not sufficient, he is favourably placed to make an effective appeal to the investor.

The introduction of innovations is not so straightforward. Innovations appealing for exploitation may be new consumable products,

offering new conveniences or new forms of enjoyment to consumers, or they may be new processes, requiring the installation of new kinds of instruments of production. In either case their experimental character is likely to stand in the way of their ready adoption. Of the two kinds the new instruments are likely to get the preference over the new consumable products. In the case of a new product, not only the productive process but the demand for the product itself is experimental. In the case of a new instrument only its net cost saving capacity has to be estimated.

A new instrument of production, even when its success is demonstrated, can as a rule only be introduced gradually. It can be embodied in the capital equipment of a new enterprise, but in existing enterprises it will usually have to wait till the appliances it supersedes are ripe for replacement. If the cost-saving capacity of the new instrument is high, the scrapping of the old appliances may be hastened, but it would have to be very high indeed to bring about a general and immediate scrapping. In many cases new consumable products will take the form of instruments of consumption in a wide sense which supersede instruments already in use, and will only be adopted gradually as the latter come to be discarded.

It is evident that there is hardly even an approximation to a selection of projects in order of profitableness. The widening of capital is guided by an expectation of normal profits; it is indeed the mechanism relied on by competitivism to reduce profits to normal in industries in which prices have been or are expected to be forced up by an insufficiency of productive capacity to satisfy demand. The deepening of capital is for practical purposes merged in the adoption of innovations, and among innovations priority is secured not so much by those that offer the highest yield as by those that can obtain financial backing. The prospect of a high yield is of course the leading attraction for the financial backing, but for any actual project there will probably be only a very limited number of people in a position to provide funds, who are technically competent to judge its merits. And at the best a technically qualified judgment is bound to admit a wide margin of error, so that, when the project ultimately bears fruit, the results may be far above or far below expectations.

The provision of housing normally partakes rather of widening than of deepening, but even there those innovations which raise the standard of capital outlay relatively to the numbers to be accommodated have an experimental character. And domestic labour-saving appliances have the characteristics of deepening.

6. The whole system is governed by profit-making. Those who raise capital, and bind themselves to pay interest, do so with a view to using the capital in profit-making enterprises. House property is no exception, for those who make a business of letting house property to

tenants look for a rent which will yield them a margin of profit after covering interest, depreciation and all necessary outgoings.

The investors themselves are not altogether excluded from opportunities of profit-making. Any shareholder in a profit-making company receives his apportionment of profit in the form of dividends, though if he acquires his shares in the open market he has to pay a price representing capitalised profits. Only in so far as he is in a position to apply special knowledge in his selection of shares will he be able to get anything more than interest and compensation for risk.

Alongside the raising and spending of capital by private enterprise are the undertakings of public enterprise. The line between them is not clear and definite. The undertakings of transport and public utilities, involving a partial or complete local monopoly, are usually subjected, even when in the hands of private enterprise, to a certain amount of public control, binding them both to render adequate service and to limit their charges. Such undertakings are 'thick' industries and often on a large scale, requiring a heavy capital outlay in each instance. If it is too large to be provided by private negotiation, the enterprise starts with a public flotation in the market, offering the investors little more than a fair interest on their money. The mere fact that charges are to be limited on account of the monopolistic position of the enterprise implies that they will be adequate, unless there is a very serious miscalculation. For some public utilities the charges take the form of dues (such as water rates) which are not very different from taxes. And some, instead of being extended to private enterprise under restrictions, are undertaken by public authorities. There may be Government-owned railways, and local authorities may undertake the supply of gas, water, electricity, local transport, etc.

In the twentieth century there has been a marked tendency for public enterprise to be extended relatively to private enterprise. Not only has the sphere of public utilities expanded, particularly with the improvement of sanitation and the increased use of gas and electricity, but the growth of social services has brought increased capital outlays especially on housing, and motor transport has called for enormously increased expenditure on roads. It may well be that even in time of peace public enterprise nowadays raises more capital than private enterprise.

Nevertheless it is private enterprise that sets the standard of the rate of interest. Public authorities do not ordinarily aim at making big profits. Some services are provided free, like the roads, or below cost, and the deficit is met by taxation (local or national), and even when a charge is made to cover costs it is usual to aim at no more than a moderate surplus.[1] Capital is raised for public enterprise at the market rate of interest, and the charges are based on the rate of

[1] Except where a State monopoly is avowedly used as a vehicle of taxation.

interest and other costs to be covered. Thus the raising of capital by public enterprise is not directed to profit-making or governed by selling power. But it is governed by *demand*, in the sense of visible need. And the capital outlay, as in the case of private enterprise, takes the twofold form of widening and deepening, according as the amount of capital outlay is merely that required by pre-existing methods of production to meet the needs or is relatively increased through the adoption of new labour-saving appliances.

The two forms of enterprise together, private and public, combine to form the demand on the resources of the investment market. And public enterprise, like private, has to accommodate itself to the resources of the market. Public authorities are indeed likely to be as ready as traders to postpone flotations when the market is unfavourable. The lesser public authorities will also be amenable to pressure from the issuing houses or investment bankers. A central Government raising capital in its own territory can afford to be independent of the issuing machinery, but still will not want to neglect the state of the market; if the expenditure for which it is raising funds is too urgent to be postponed, it will probably resort to short-term borrowing. On the whole, apart from temporary postponements, public enterprise will be less influenced by the state of the market; it will be the first charge on the resources available, and the fluctuations will be primarily in the capital raised by private enterprise and the corresponding capital outlay. But public enterprise, though making less automatic response to the state of the investment market, is more susceptible to a discretionary regulation on grounds of policy. And so have arisen the proposals referred to above (pp. 94–6) for using variations in the amount of capital outlay of public enterprise as a means of influencing the state of industrial activity.

7. Competitivism leaves capital outlay to be directed primarily by private enterprise, and to be adjusted to the available resources by the action of the investment market. The resources of the investment market consist over any long period of current savings, subject in a short period to an addition on account of any release of cash from balances or bank advances, or to a subtraction on account of any absorption of cash into balances or into the repayment of advances. Current savings are determined by the free discretion of the recipients of income, or, in the case of reinvested profits, of the traders who control them.

Current savings are a fluctuating quantity. They fluctuate mainly in response to the fluctuations of income. A man with a steady income can take a long view of his need for saving; he can plan his standard of living so as to leave a determinate excess of income over consumption. But a man with a fluctuating income cannot easily adjust his consumption to its variations. He will rather estimate what

average style of living he can afford, and adhere to that, leaving the fluctuating residue of income to form his savings. Some variation in his expenditure he will probably make, but it will mainly be in the residue of saving that the fluctuations will be felt, so that the proportional variation in his savings will be far greater than in his income as a whole.

As we saw in Chapter II, it is above all from large precarious incomes that large savings are made, and far the greater part of large precarious incomes are those derived from profits. Wages are often precarious, but are too pressingly needed for current living expenses to leave any considerable margin. Salaries in the higher ranges provide a more substantial margin, especially in the form of life insurance, but they are usually less precarious than wages and less fluctuating than profits. The possessor of a big income from fixed interest or from rents of land and houses, who can look forward to a well-secured perpetuity, has no motive for saving at all, except in so far as he must take account of possible mishaps (though, if he wants to endow a family, he must provide for death duties). He may save from superfluity if, when all his needs have been amply met, he finds that his income has not been used up. But few such incomes are as big as that.

The motive for saving is perhaps strongest of all in the case of large professional incomes derived from fees. But they are a far more limited class than that of the profit-makers. The profit-making trader has capital of his own, but without his personal activity it would yield no more than interest, so that the excess of his profits over bare interest, like the professional man's income from fees, is quite unsecured. Moreover his capital is tied up in his business, and in an unfortunate year may fail to yield even interest.

Thus a very large part and the most fluctuating part of a modern community's savings is derived from profits.

One big section comes from undistributed profits, reinvested in the enterprises that earn them. Most concerns avoid wide or frequent variations in the rate of dividends they distribute to shareholders or partners, so that the fluctuations in profits are to a great extent absorbed in an undistributed residue. A successful concern will allow this residue to grow to a considerable proportion of the whole, investing so much as is not immediately needed for its business in marketable securities (usually of a conservative character, such as Government securities), which can be sold when the time for extension comes.

Competitivism attains a natural harmony in the provision of funds for extension of capacity in those concerns which have been making the biggest profits and are likely (though not certain) to find a future demand that will justify the extension. The direction of investment under the competitive system has often been criticised on the ground

that when an expansion of demand for any product is experienced, many concerns are likely to start enlarging capacity to meet it in ignorance of one another's plans, so that they may go too far, and waste resources in creating capacity in excess of what the demand justifies. But this is only one particular form of error in a business in which human fallibility is bound to be displayed in many. The widening of capital is sure to be carried too far in some industries, not far enough in others. The former will suffer from overproduction, and a narrowing of their margin of profit, and possibly from an under-employment of plant (not, however, as is often assumed, from an under-employment of labour). The widening process will be checked in these industries until demand has overtaken capacity, or if that never happens, a part of the excessive capacity will eventually be discarded and scrapped. On the other hand, industries where extensions of capacity have been allowed to fall behindhand will in turn offer a profitable field for capital outlay.

These miscalculations cause some waste and loss. Not only is there loss from idle capital which may never be fully employed till it is reduced by scrapping, but there is a loss of profit, for every concern in the industry will go on producing so long as the price it receives yields any margin above its overhead costs, even if the margin is less than the market rate of interest on its capital. That, it may be said, is no real loss, because the consumers have the advantage of the low price of the product. But the consequence may be that the industry, deprived of the normal accumulation of reinvested profits, and unable to offer an attractive opening to the investment market, will fall behind in the progress of renewals and improvements, and will be found to have corrected its over-development by a deterioration of its equipment, when what was needed was a curtailment.

8. The widening of capital *as a whole* may go too fast. That is sometimes adduced as a cause of unemployment. But the existence of plant in excess of what can be manned will cause an intensified demand for labour rather than unemployment. Nor will it necessarily cause under-employment of the instrumental industries. For if too great a share of the resources of the investment market has been directed to widening, too small a share will have gone to deepening, and there ought to be arrears of profitable innovations waiting to raise capital.

Deepening indeed appears as a balancing factor in the investment market, the residual claimant on the market's resources. The working of the mechanism depends on the opportunities for deepening always being available.

For a century and a half mankind has unremittingly evolved a continuous succession of labour-saving innovations, so that the amount of capital equipment that can be profitably used by a given labour force has been perpetually growing. Depression has from time to

time caused a temporary discouragement of enterprise in the direction of deepening as well as in that of widening, but the opportunities of deepening have never come near drying up. If they did dry up, and if, as is usual in any country not in an early stage of development, the amount of widening (including all desirable public works) needed to keep pace with the growth of the working population were not sufficient to absorb current savings, the economic organism might be brought to a breakdown. People would go on accumulating, and there would be an insufficient supply of wealth capable of accumulation.

Economists sometimes seek to explain trade depressions as due to such a breakdown having actually already occurred, especially when recommending expenditure on public works as a remedy. We saw in the last chapter (p. 95), that any deficiency of demand in relation to production can be represented as a deficiency of capital outlay in relation to saving, but that this is merely a result of the meaning of terms, and throws no light on causes or remedies. But the behaviour of the investment market at times of depression is often such as to suggest very forcibly that one at any rate of the characteristics of depression is an insufficiency of projects for capital outlay to use up the available savings.

And even when the cause of a depression is a monetary contraction, a heavy decline in capital outlay is sure to result. The falling off of activity leaves most industries with an excess of productive capacity unused, and the raising of capital for extensions of capacity is reduced to a low level. Widening may be almost suspended except in anticipation of revival. That in itself need not cause a deficiency of capital outlay, because concurrently there will be a heavy decrease in savings, due especially to the shrinkage of profits. But the resources of the investment market are not confined to savings. At a time of depression traders sell off stocks of goods and replace them with smaller stocks at lower prices. Manufacturers receive payment at relatively high prices on pre-existing contracts, and incur costs on a lower scale and on smaller quantities in executing new contracts. There is in fact an extensive liquidation of working capital, so that in the composition of traders' assets money is substituted for goods. A part of the money will be applied to repaying bank advances, but some will be received by traders who have no bank advances outstanding. Much of this money will be placed in the investment market in good marketable securities which can be resold when the need for working capital revives, and will earn interest meanwhile. And the repayment of bank advances will lead the banks to look for new assets to replace them. If, as is likely, they cannot find willing and eligible borrowers, they will start buying securities in the investment market.

Thus the investment market may experience a big accession of funds to compensate, and very likely for a time to exceed, the shrinkage

of savings. The market becomes highly favourable to the raising of capital, but capital outlay takes time to respond to a favourable market, and there may be a considerable interval before enterprise has expanded sufficiently to use up the available resources. The interval tends to be all the longer at a time of depression when industries, however glad they may be to introduce any innovations that will save costs, are extremely reluctant to commit themselves to anything that will increase their output.

It would be a complete misinterpretation of these phenomena to infer an actual drying up of remunerative projects for the deepening of capital. The possibility, however, of this occurring at some time in the future is a topic to which we shall return in Chapter XVIII (pp. 293–6).

9. There is another aspect of competitivism in relation to capital enterprise which has been an object of attack. The private ownership of land not only opens the way, as we saw in Chapter II, to easy money-making by way of an unearned increment, but it gives the landowners a power of decision as to the manner in which land is to be used. Competitivism assumes that every landowner will wish to put his land to the most profitable use. Even if he deliberately forgoes an opportunity of getting a higher yield from it because he prefers some use of which the yield is lower, then he is really paying for his preference a price equal to the difference of yields. If he chooses to pay the price, then according to competitivism that is what it is worth, and the land is after all being put to its most profitable use.

Nevertheless the private ownership of land may interfere materially with economic development. A very large part of capital outlay is applied to structures and improvements which once installed are inseparable from the land. The parcels in which the land is distributed among the owners have been determined by past history, and may bear no relation to the subdivision that would be suitable to development. A very big estate can be dealt with as a whole, and subdivided in what the owner believes to be the best way. But the subdivision itself creates smaller properties which will complicate future changes. Even if the properties created are leaseholds, the variety of purposes to which they are applied will probably preclude the leases all ending simultaneously, and buildings, structures and improvements installed will have effective lives of varying duration.

The self-interest of landlords and farmers does tend to attain the most suitable delimitation of farmlands and holdings, subject always to the imperfections of all things human, for example the excessive subdivision of peasant holdings by inheritance. But when it comes to town planning, the self-interest of landlords and builders is apt to produce deplorable results. A growing town offers the prospect of a windfall to any landowner whose property comes into demand for building. Each landowner has to judge for himself when the moment

has come to realise the windfall. If he takes action prematurely, he will only be able to get relatively low ground rents; if he waits, he may find that urban development has been diverted into another direction and the opportunity has been lost. The decision is a speculative one, and takes no account of what is desirable for the inhabitants of the town, unless either the landowners are public-spirited enough to co-operate with that end in view or a Governmental planning authority is given the requisite powers. It is rather the provision of housing and urban amenities than the location of industry that suffers from the haphazard decisions of private landowners, for the industrial plant itself does not absorb so much land and the needs of the manufacturer for communications with his markets and the source of supply of his materials give his preferences in the matter of position definiteness. But there may well be difficulty in obtaining a site which combines suitable size and shape for the installation of plant with the essential advantages of position.

In the case of mining the necessity of conforming underground development to the boundaries of properties on the surface may be a serious disadvantage. That has led in Great Britain to the nationalisation of coal mining royalties, a measure which means the nationalisation not only of the revenue derived from the royalties but of the freehold rights to which they attach.

Any plan for using a plot of land involves capital outlay which will be partly wasted if the land is turned to another purpose. In the case of agricultural land the capital outlay for a given area is very much less than in that of urban land, and so, when agricultural land becomes ripe for building, the capital sunk in it is readily let go and paid for by the enhanced site value. But even in the most thickly populated country a very small proportion of the agricultural land is taken up for building, and for the rest it remains true that it is only worth while to incur the capital outlay involved in bringing land into production if it is to remain in use for a considerable period of years.

Capital outlay, even when it is not applied to land, for example when devoted to the production of movable plant, to shipbuilding or to the initial organisation or publicity of an enterprise, is a commitment. If it fails of its purpose, it is likely to be wholly or mainly irreversible. But when applied to land it is doubly a commitment, for the land is committed as well as the capital.

The hazards of let-do and trial and error work tolerably well with capital outlay itself. It is not certain that the wastage is any more than is an inevitable result of human fallibility. But the defects of trial and error are more serious in the determination of the use of land, and systematic planning in some form is needed.

CHAPTER VIII

INTERNATIONAL TRADE

1. We referred in Chapter VI to the foreign exchange market in its monetary aspect. We have next to turn to a consideration of the activities out of which the transactions of the foreign exchange market arise.

At the outset it is necessary to make a distinction between *current* transactions and *capital* transactions. Unfortunately no clear boundary can be drawn between them. The current transactions can perhaps best be apprehended as transactions on income account. A country's income is partly spent on things imported from abroad, finished goods imported ready for consumption, materials used in manufacture for home consumption, or services rendered by people in other countries or by their capital equipment towards producing, transporting or handling goods for home consumption. And the country will at the same time derive part of its income from producing goods for export and rendering services to people in other countries.

A country may also invest a part of its current savings in the acquisition of foreign securities or property. That is still expenditure out of income. But is it to be treated as a current item by the country which sells the securities or property? Clearly in certain aspects it should not, for the country is parting with capital assets and incurring future liabilities for interest or dividends, and possibly for the repayment of capital sums. Nevertheless for some purposes this disposal of capital assets must be treated as a current item. For where a country is in course of development by the aid of foreign capital, it may go on incurring capital outlay at the expense of foreign investors for many years. The people employed upon the production and installation of new capital will be deriving therefrom incomes the spending of which will attract imports to the country where the capital outlay is incurred, and this state of things, while it lasts, will enter into the calculations of the market as a continuous and regular factor.

If the transactions in the foreign exchange market were confined to current items so understood, equilibrium would be secured by equalising the current debits and the current credits. That would mean enlarging or diminishing the equivalent of the consumers' income in foreign currency units, and so giving the people a greater or smaller power of attracting imported goods. The adjustment can be accomplished either by modifying the consumers' income itself in terms of its own unit, or by modifying the rates of exchange which relate the unit to foreign units. The gold standard, forbidding any departure from fixed parities, compels resort to the former method, involving a monetary

expansion or contraction. When rates of exchange are free to vary, equilibrium can be attained consistently with the consumers' income, and the price and wage structure, remaining unchanged in terms of the monetary unit.

The foreign exchange market, however, has to face capital transactions as well as current transactions, and the former may attain such a magnitude as to threaten the market with a breakdown. If current transactions are those entered into on income account (including the investment abroad of surplus *current* savings), capital transactions are purchases or sales of money abroad in excess of what is requisite on income account. The amount of money that *can* be applied to the purchase of foreign exchange at any given moment is likely to be very large. Purchasers are not limited to the amount of money immediately in their hands, but can add to it by borrowing from the banks or by selling securities, and the buyers of the securities may raise the purchase money by bank advances.

The amount of the resources potentially able to operate in the foreign exchange market might thus quite conceivably be several hundred times an average day's turnover.

The fortuitous inequalities of the current transactions of any centre in foreign exchange may be considerable, but in themselves, being felt gradually, they do not overstrain the market. It is when something happens to excite an expectation of big changes that the trouble begins. Such an expectation may inspire a speculative movement which will precipitate huge purchases or sales of foreign exchange in an hour. That is especially apt to occur when people fear that the foreign exchange value of a particular currency unit is about to depreciate. Foreign holders of the money will hasten to sell it, while the people of the country will hasten to buy foreign exchange, some in anticipation of future commitments at foreign centres, others as a speculation. In extreme cases there is a flight from the currency, a panic rush to be rid of any assets depending for their value on the tainted currency unit, and to transfer resources into safer forms, such as commodities, property or foreign exchange.

This kind of speculation against a currency does not take place without some reason. It may be that the Government of the country has become involved in a course of inflationary finance from which it lacks the wisdom or the courage to extricate itself. Or the banking system may have allowed a state of inflation through trade borrowing to develop and get beyond control.

Or the weakness of the currency may be due not to inflation at home but to deflation abroad. If the currency unit is linked to foreign units by a gold standard or any other system of fixed rates of exchange, deflation abroad, taking shape in a shrinkage of demand and a fall of prices in world markets, will cause a decline of the country's exports

and an increase of its imports. If the country finds the strain of applying a corresponding deflation to its own credit system too much for it, it will have to draw on its reserves of gold or foreign exchange to meet the adverse balance of payments. The drain on the reserves, if considerable enough to threaten them with exhaustion, will provoke a fear that the foreign exchange value of the currency cannot be maintained, and if the fear becomes general, a speculative movement may sweep away the remaining reserves in a moment.

The fugitive money, moving from one foreign centre to another, which has so disturbed the foreign exchange markets in recent years, is often attributed to fears of war or revolution. And no doubt political insecurity has been an important contributory cause of them. But even political insecurity works quite as much through anticipations of inflationary finance as through fear of confiscations and defaults. And all the time monetary instability has been at work. The adjustments following the inflationary years 1919-23 were hardly completed, before the depression which more than doubled the wealth value of gold between 1929 and 1933 set in.

This situation has figured prominently in the indictment against the gold standard. And so long as there is no safeguard against a world-wide rise in the wealth value of gold, the gold standard is liable to it. But with such a safeguard the gold standard can be freed from the danger. And the trouble is not confined to the gold standard; it results from *any* monetary policy which overvalues the currency unit. In fact a 'weak' currency is an overvalued currency, one which makes the country's exports too dear abroad and its imports too cheap at home.

2. The currencies of the world cannot be all overvalued in terms of one another, but they can be all overvalued in terms of wealth, or rather in terms of labour. That occurs in case of a general deflation under a gold standard. The currencies of those countries which are most successful in effecting deflation are the strong currencies; those of the less successful are the weak currencies.

One aspect of a general deflation is a great pressure to maintain exports. Exports are at all times highly esteemed, but at times of full employment, when productive resources displaced from export industries are in demand elsewhere, positive measures to expand or maintain exports are less needed than at a time of general unemployment, when additional exports employ resources otherwise idle. At a time of general deflation and world-wide depression, all countries are pressing exports on one another.

But it is just at such a time that recourse is had to foreign exchange control and import restrictions. To impose foreign exchange control, the Government takes over the whole business of dealing in foreign exchange, and uses its monopoly to prohibit dealings except for current

purposes. Exchange is supplied to pay for imported goods, but imports are restricted by a licensing system, and exporters are required to surrender the proceeds of sale of their goods in foreign exchange. Provided the control is effectively enforced, speculative purchases of foreign exchange and of assets abroad can be prevented, reserves husbanded and rates of exchange maintained. If the rates of exchange established by the control are such as to be consistent with an equilibrium of current transactions, the distrust of the currency is likely to pass, and the control can then cease.

It is possible to arrive at an equilibrium of current transactions by a restriction of imports of goods. That is a way of escaping the dilemma of choosing between a monetary contraction and a depreciation of the currency. It is not a complete defence once a speculative movement against the currency has set in, but it may succeed in so far relieving the strain on the reserves that the conditions leading to such a speculative movement never develop. One of the attractions of a protective tariff is that it alters the equilibrium relation of the currency unit to the units of other countries, permitting a certain amount of monetary expansion, accompanied by the forbidden pleasures of inflation, without the outward evidence of depreciation in relation to foreign currency units or gold.

For a protective tariff has the effect of discriminating against imported goods in favour of those produced at home, and consequently of diminishing imports. A monetary expansion is called for to give the people an increased power of buying imports, and so equilibrium is restored. In the particular case where a country is being infected by a world depression, involving it in falling prices and growing unemployment, the temptation to alleviate the trouble by imposing or increasing a protective tariff is obvious. It may well be that to a great extent the imports dispensed with can be replaced at such a time by home products, bringing idle capital and labour into employment with very little increase of prices. In other words the increase in the consumers' income takes effect mainly in an increase in production, so that there is no considerable depreciation of the purchasing power of the monetary unit.

Nevertheless this cannot be a real solution of the problem of depression. It is no more than a partial remedy, for while it does correct the excess of imports, which is the immediate cause of weakness in the foreign exchange position, and shields those industries which are in competition with imported goods from the effects of the collapse of demand and of prices in world markets, it leaves the export industries exposed to the full force of the storm.

Moreover a limitation of imports, whether by protective duties or any other method, cannot be viewed as a purely monetary measure. It has important economic consequences, and the decision whether to

adopt it should be based on a full consideration of those consequences. And whatever its merits or demerits, a system of regularly raising import duties at times of depression and reducing them again at times of activity would be so unsettling as to be intolerable. Nor would the alternative of raising duties higher and higher with each successive depression, and never reducing them, be any better.

3. The depression that started in 1930 put an unparalleled strain on monetary systems, and there had already been a noticeable tendency to increase import duties and to supplement them with quantitative limitations of imports, before the financial crises of 1931 impelled a number of countries to impose exchange control.

Experience has gradually revealed the implications of exchange control. Its starting point is the prohibition of the purchase of foreign exchange for any but permitted purposes, or at any but official rates of exchange. Permitted purposes are probably equivalent to what I have called current purposes (subject to import restrictions), except that all export of capital (even in a country where that is normal) might be excluded. But if people are not allowed to *purchase* exchange for any but current transactions, it is obvious that they cannot be allowed to *hold* exchange for any other purposes. Foreign exchange may be acquired by various means other than purchase—for example, by the sale of exports, by services rendered to foreign traders, from interest, dividends, or profits on foreign investments. The prohibition of transactions therefore has to be supplemented by a compulsory surrender of all foreign exchange not needed for permitted transactions.

That, if successfully enforced, means that the whole available supply of foreign exchange comes into the hands of the control. Indeed under any other arrangement it would hardly be possible to impose the official rates of exchange on the market. The obligation to surrender exchange gives the control something like a monopoly of dealings in the market, since all foreign exchange not earmarked for a permitted transaction must pass through its hands. The control will pay for foreign exchange at official rates, and will sell it for permitted purposes at the same rates (subject to a fractional ' turn ' or difference between the rates by way of commission).

The control will acquire balances of exchange on all the foreign centres with which the country has dealings. It will find itself gaining credit balances in some centres and incurring debit balances in others. If it were the only country applying exchange control, it could proceed, like any other dealer in foreign exchange, to sell the credit balances to other dealers, and to buy enough money at the centres where there are debit balances to cover them. But when balances are held in other countries in which exchange control is imposed, this procedure is not available. The debit and credit balances at the free centres can be covered by dealings in the market, but a credit balance at a controlled

centre can only be drawn on for a purpose permitted by its control. And if there is a debit balance to be covered, a purchase of the money of the creditor country with that of the debtor country may be prevented by the exchange control of the former, so that the debtor country may have to offer money in some third country, where there is no exchange control, to procure the means of meeting its liabilities.

A country which has imposed exchange control in order to protect its reserves and to sustain the foreign exchange value of its currency unit will not want either to be burdened with credit balances in foreign-controlled currencies which it cannot use, or to be compelled to draw on its precious reserves of free currencies to meet debit balances.

4. There is therefore a tendency, as between any two centres which have both adopted exchange control, for the controls in both to aim at preserving an exact balance in their transactions. There have resulted what are called ' clearing agreements,' under which two countries in that position agree what imports each shall admit from the other, and at what rate of exchange their currency units shall be reckoned in settling accounts.

Two countries making such agreements can afford to be liberal to one another. Their exchange control exists to guard their reserves of free currencies or of gold. Balances of foreign-controlled currencies are not to be reckoned as reserves, and neither country will hesitate to allow the spending of any balance it may hold in the other.

Now when exchange control restricts imports, the effect is to raise the prices of the goods affected above the equivalent of prices in world markets at the rates of exchange applicable to imports. Permission to import becomes a valuable privilege. When therefore a clearing agreement allows traders in one country to export to the other, they are being given a more favourable market than they would get in free exchange countries. The clearing agreement discriminates in favour of the countries participating in it and against outsiders. In effect they subsidise one another's exports.

There are limits to the extent of such agreements. If there are several, the admission of goods imported under them lowers the price of the goods. Even before the price has fallen to the world level, the home producers will begin to feel the competition and to ask for protection. And, if goods exchanged between the two countries (along with any other current transactions) do not balance, the excess has to be paid for. Sometimes a country will undertake to pay for an excess of imports from another in free exchange up to an agreed amount. It can afford to do so if it can at the same time obtain a clearing agreement with some third country under which it will receive a similar payment.

In fact the countries exercising exchange control, in so far as they have sufficient commercial intercourse with one another to lead to

clearing agreements, tend to form a closed group, within which there is much less impediment to the interchange of goods than between any country in the group and the free exchange countries outside.

The free exchange countries are thereby put in a difficulty. Their imports from the controlled countries are greatly diminished, since the rates of exchange established by the controls overvalue the currency units of these latter and make their prices unduly high. And there is no security that the imports of the controlled countries from the free will be paid for in the currencies of the latter The exporter, in the absence of any express stipulation, may find himself receiving payment in the money of the importing country which he can only use for a ' permitted ' purpose. In some cases agreements have been made between the controlled countries and the free, providing that the former shall apply the proceeds of their exports to the latter to pay for their imports from them and to meet other specified current liabilities. So long as the volume of the free countries' trade with the controlled is governed by their imports from the latter, and these imports are kept down to a minimum in consequence of the artificial rates of exchange, the free countries are at a disadvantage.

Sometimes indeed the limit fails to operate. The opportunity of buying from the free country is sure to be attractive to traders in the controlled country, and unless precautions are taken against excessive buying, the payments through the clearing for imports from the former into the latter get into arrears. In other words, the controlled country becomes indebted to the free country, and the exporters have to wait for payment. In some cases the period of waiting has grown from months into years. Inevitably steps are taken to enforce the limit and clear off the arrears. But that means a severe contraction in the free country's export trade.

Nor is this state of things entirely satisfactory to the controlled countries themselves. The whole system of exchange control having been adopted to sustain rates of exchange, the monetary authorities cannot fail to wonder whether this object is after all so very desirable. When illicit or ' black ' markets spring up to evade the exchange control, and quote the currency unit at a far lower value than the official rates of exchange, it begins to look as if the desired end had only been very imperfectly attained. And in virtue of the official monopoly, it becomes possible to adopt different rates of exchange for different purposes. Each clearing agreement may have its own rate of exchange not necessarily corresponding to the relative rates of exchange of the two currency units in terms of other units. Even within one clearing agreement there may be different rates of exchange for different commodities. A favoured export trade, for instance, may be allowed to value the proceeds of its sales at a high rate.

In an agreement with a free exchange country a controlled country

may adopt a special rate of exchange in order to make its export trade more profitable. By the time all its foreign trade is brought under one type of agreement or the other, there will be little trace of any standard rate of exchange. Even the black market, when it is no longer resorted to to make exports to free exchange countries remunerative, is practically confined to people who want to transfer their capital abroad. A flight of capital actuated by political motives may be at fancy rates of exchange of no significance, even though rates for current transactions have been adjusted to the needs of the market, and there is no longer ground for anticipating a further depreciation.

Exchange control has often been practised in the past. The countries which suffered from inflation in the years 1919–23 had recourse to it, but with little success. In face of the extravagances of inflation, which might destroy a fortune in a few days, the motive for evasion was so overpowering that no official control could stand against it. At that time the technique of clearing agreements and payments agreements had not been evolved, and the black bourse was very apt to become the effective market and to leave the official rates of exchange high and dry.

In 1931 and the succeeding years the situation was quite different. The trouble arose not from inflation in the countries which imposed control, but from deflation in those which remained free. If there was distrust of the currency units of the former, it was limited to an expectation that they would depreciate relatively to gold and gold standard currencies, not relatively *to commodities*. There was therefore no actual expectation of loss from holding assets depending for their value on these units; the holder would merely miss an opportunity of making speculative gains and by no means a certainty, since, as it turned out, all the great gold standard countries were driven one after the other to abandon the gold standard, till in 1937 none of the old gold parities had survived among them.

At the same time experience had led to the administration of exchange controls being tightened up. In a few countries black markets acquired considerable importance, but in most they were either non-existent or confined within narrow limits.

Exchange control when it started under the stress of acute depression and financial crises was primarily a monetary measure. But its effects reached far beyond the monetary sphere. It placed the greater part of international trade under restraints so rigorous and so penetrating as to destroy the operation of competitivism. And there are few economic activities in any modern country that are not linked more or less intimately with international trade. It is only by a chance coincidence that a country's output of any natural product, whether agricultural or mineral, just meets its own needs and no more. In general there is either an exportable surplus or a deficiency to be met

by imported supplies. That means that the producers of the natural product are in competition with foreign producers. It also means that some manufacturers are dependent on imported supplies of materials.

Manufactures are more displaceable than natural products; they can be produced at any place possessing adequate communications with supplies of materials and with markets. But they tend to be concentrated at the points of best communications, wherever sufficient numbers of competent personnel can be found or attracted, and every concentration of manufacturing industry depends on external markets, a part of which will usually be external not only to the district but to the country, and will be reckoned as export markets. Among the manufacturing industries of any country those which depend on export markets are likely to be the most important. And the weaker manufactures with no exports are likely also to have contact with international markets in that they are exposed to foreign competition in the shape of imports.

Thus the portion of economic activity which is without any direct contact with foreign markets will be very limited; it will exclude nearly all material products, and will consist chiefly of the rendering of services such as transport, teaching, entertaining and purely personal services, and the upkeep, repairing and cleaning of material objects and property.

Exchange control puts international trade on a footing not very different from that of a collectivist or communist world. Sales of any product from one country to another require prior government permission, which is measured out with reference to a policy beyond the ken of the trades engaged. The Government is enabled, by attaching conditions to its permission, to control the actions of the traders not only in their international dealings but in the whole of their business. The industrialist who is dependent either on imported materials or on export markets will comply with any practicable conditions rather than see his business so cut down as to involve him in ruin.

In countries which do not aspire to the totalitarian model, these powers may remain dormant, exchange control being exercised with a view to an impartial apportionment of opportunities among all traders. It was in Germany that the opportunity was taken to subject industry to a totalitarian discipline. Exchange control was imposed in Germany in July 1931, when Hitlerism was still only a threat. In eighteen months the threat materialised, and Hitler and his associates found the way already prepared for the control of all German industry.

And in another direction exchange control proved to be a convenient instrument for the furtherance of national socialist plans. Germany made clearing agreements with other countries all over the world which had also adopted exchange control. In every case the

discriminatory effect became a link tying the economic interests of the other country concerned to those of Germany. All the economically weak countries of Europe and South America soon seemed to be on the way to becoming economic satellites of Germany. Against this tendency no effective defence was discovered by the other leading commercial nations, so long as they did not themselves adopt exchange control. The only adequate remedy would have been a system of clearing agreements based on rates of exchange valuing the free currencies high enough to offset the high prices due to the import restrictions of the controlled countries. Some progress was made in that direction in a few cases, but it really meant abandoning the essential purpose of exchange control, the maintenance of rates of exchange at an artificial level.

5. International trade has long been conspicuous as the field of controversy between competitivism and the rival policies to the attacks of which it has been exposed. Against the mercantilism of the eighteenth century, which followed every device for stimulating exports and keeping down imports, in the hope of creating a 'favourable' balance of trade, competitivism urged the advantages of a geographical division of labour. It would be to the advantage of everyone that things should be produced in the places where costs were relatively lowest (costs of course including the cost of transport to market). Free competition would ensure this, and, if it were allowed to operate without impediment, exports would take their proper place as nothing more than the means of acquiring imports. The implication was that the proceeds of a favourable balance could only be an accumulation of gold and silver of no use except ultimately for the acquisition of imports. To discriminate against imports and in favour of exports would therefore be to sacrifice the end for the sake of the means.

Even in Adam Smith's day external investment was not unknown. There was, for example, a large Dutch holding in the British national debt. But it was not till something like a century later that economists began to recognise the accumulation of external investments as the natural aim of a favourable balance of payments.

The fundamental principle of the geographical division of labour stood. It was indeed applicable to external investment as well as to the interchange of commodities. An internationally organised investment market enabled enterprise to enter upon capital outlay in whatever part of the world it would be most remunerative, and to draw upon the accruing accumulation of savings wherever available. Any centre which was making a surplus of savings available for external investment would find itself with a favourable balance of payments.

Competitivism thus accepted a favourable balance of trade as desirable. But that did not imply approval of impeding imports by tariffs for the sake of a favourable balance. Indeed, unless the relative

yields of investment at home and abroad were such as to make external investment more attractive, the policy of impeding imports would fail to secure any but a very ephemeral favourable balance. If external investments were not attractive, the balance would after all be settled in gold, and imports of gold would continue till the country's price level had so far risen above the world price level as to redress the balance of trade and eliminate the favourable balance.

The competitivist citadel of free trade was assailed on several sides. The most effective attack was on the ground of unemployment. The theory linking together an unfavourable balance of trade, a loss of gold, deflation and unemployment was not assimilated in the economics of the nineteenth century. But the direct effect of foreign competition in making industries unprofitable and throwing people out of work was only too obvious. The free trade argument, that the labour displaced would find employment elsewhere, seemed to require a reduction of wages for fulfilment. A protective tariff offered a remedy which would avoid the reduction of wages. It was only a partial remedy in that it did nothing for the export industries, but when the advocates of free trade argued that the export industries would be put at a disadvantage because the tariff would raise the cost of living and so involve an increase of wages in terms of money, the controversy began to get too elusive for the ordinary trader or trade unionist.

The first decisive success of free trade a century ago was against a really burdensome agricultural protection in an industrialised Great Britain, the old Corn Law. The cost of living was the principal issue. But in later phases of the controversy depression and unemployment favoured protection, while prosperity and activity (with the usual accompaniment of high prices) favoured free trade.

Competitivism was always too prone to measure the desirability of anything in terms of wealth, and to pay insufficient regard to consequences which, though not directly measurable in terms of wealth, were still economic in character. The free play of competition might maximise the productivity of the population of a country; yet a departure from it might open to them more eligible occupations at no more than a moderate sacrifice of wealth. The competitivist might argue that they could equally well secure themselves the more eligible occupations at a sacrifice of wealth by simply engaging in them for less pay. But that would not suffice to get new industries started. And indeed competitivism allowed an exception to the general principle of free trade in favour of 'infant industries,' which needed the shelter of a tariff to begin with, and might be expected to dispense with it once they had gained experience. But it could not be assumed that the industries that could hold their own under those conditions would introduce a sufficient diversification into the industry of a country fitted by natural resources for extreme concentration on a limited field

of production. Such a country may find itself meeting nearly all its needs by importation and with very little economic activity outside its great staple export industries. If it is a new country in course of development, and short of labour, very high wages may be paid by the export industries, so that no others can compete successfully for the available supply of labour, unless they are sheltered either naturally or artificially from foreign competition. A protective tariff on imported manufactures may transfer to the country industries which would otherwise be supplying its needs from outside, and diversify occupations at relatively little real cost. It may not even greatly retard the development of the staple export industries, for the protected manufacturing industries may attract additional immigration and additional capital. Considerations such as these have contributed to the adoption of protectionism in new countries, especially in those which, being exporters of staple foodstuffs, are assured of a supply of them at world prices to keep down the cost of living.

But the principal cause of the success of protectionism has been the prospect of direct profit offered by it to all those engaged in the protected industries. The fact that that profit was to be made mainly at the expense of consumers counted for little; consumers offered only a very diluted resistance to the concentrated political pressure of an industry seeking for protection. Only occasionally could the forces of free trade be effectively mobilised, sometimes against visibly oppressive duties like those under the old Corn Laws, sometimes when free trade had existed long enough to give rise to powerful vested interests in export industries.

The controversy of free trade and protection was in a way conducted on a false basis. Ostensibly the issue was one of more and less wealth. Supporters of either cause sought to show that it would conduce to the material welfare of the individual. But all the time there was underlying the controversy a deeper divergence. Protection, whether beneficial to the country practising it or not, was in any case a policy of discrimination against foreign interests. Indeed the protectionists avowedly regarded this as an advantage, while the free traders, reluctant to come forward as advocates of the welfare of people outside their own country, preferred to argue that protection, whatever its effects on foreign countries might be, would defeat its own aims at home.

The real significance of protectionism is as a measure of economic nationalism, a means of threatening or inflicting injury on other countries. The imposition of a new or increased duty on the importation of any commodity, inflicts an immediate loss on the producers in the countries from which it has been imported. The threat of it may extort concessions in other directions, or reductions of duties may be offered as an inducement. Protective tariffs thus offered a wide field not only for international friction, but for bargains between two

countries at the expense of a third. And these contingencies introduced paralysing risks into international trade. Traders built up an export trade at their peril, if it was liable at any time to be made unprofitable by discriminatory duties.

6. The nineteenth-century movement in favour of free trade found a valuable safeguard, where the protective policy persisted, in the inclusion in commercial treaties of a 'most-favoured-nation' clause. That clause bound either country not to admit imports from any third country at lower rates of duty than those applied to imports from the other. Any country that enjoyed the benefit of the clause in its treaties was safeguarded against any avowedly discriminating duties placing its goods at a disadvantage in competition with other exporting countries.

The most-favoured-nation clause had been a feature of commercial treaties in the seventeenth and early eighteenth centuries, and, after an interval of neglect, was revived in Cobden's Anglo-French treaty in 1860, and has been widely adopted ever since. One of the most pernicious consequences of the system of quantitative restrictions of imports and foreign exchange restrictions, which came into vogue in 1931 and subsequent years, was that they made the most-favoured-nation clause inapplicable. When it has to be decided what relative quantities of imports of any commodity from different countries the equality of treatment contemplated by the clause would require, a variety of calculations can be put forward, no one of which can claim authority.

The restriction of imports, though adopted on monetary grounds, to support the foreign exchange value of a currency unit, has none the less possessed all the characteristics of extreme protectionism. It has created vested interests among the industries profiting by it, has inflicted heavy losses on the industries which have found their export markets cut off, and has been identified with the political aims of economic nationalism.

The most-favoured-nation clause has been criticised in that it prevented a relaxation of tariffs between adjacent countries, by which at any rate a beginning might have been made in the removal of obstacles to trade. A reduction of import duties by Belgium and Holland in favour of one another's products would have involved discrimination against other countries, such as Great Britain, with which they had commercial treaties including the clause.

But to suppose that agreements of that kind would be a move towards free trade is a delusion. The preferential treatment that would have been given by Belgium and Holland to one another would have made their existing protective tariffs more exclusive against other countries. In fact the wider the extent of economic activity encircled by a tariff barrier of given height, the greater is its effect in excluding

the goods of foreign producers. The break-up of the Austro-Hungarian Empire resulted in the creation of new frontiers, and the new tariff barriers obstructed trade between one succession State and another. But if the import duties had remained at the same level as before, the markets which the succession States lost in one another would have been more accessible than before to outside producers.

A colonial Power which includes its dependencies in a single customs union with itself discriminates more severely against foreign exporters than if each dependency has its own tariff.

It may be that the most effective retort of the countries with free foreign exchange to the discriminatory effect of the clearing agreements entered into by the exchange-control countries would have been a system of tariff preferences reserved to themselves. But unless the preference extended to all free-exchange countries, the troubles of those excluded would have been intensified.

Protection, as we have seen, is a product of economic nationalism. Discriminating tariffs tend to develop into political links between the countries which give one another preferences, and to mark more deeply the antagonisms of those which discriminate against one another. The most-favoured-nation clause prevents such proceedings, and the machinations of National Socialist Germany have shown how dangerous its suspension may be.

7. The monetary cataclysm of the nineteen-thirties has worked havoc in another part of the economic system of the world. There are countries that specialise in the large-scale production of primary or natural products and export them to the industrial countries to be used in manufacture. These are agricultural, pastoral, forest or mineral products, the output of which cannot be easily or quickly adapted to changes in market conditions, and highly organised markets have been evolved to deal with that problem. Prices are sensitive, and their variations yield profits to skilled speculators and dealers, who provide for the carrying of stocks to cover any unexpected deficiency of supply or to hold a surplus till it can be absorbed.

Ordinarily the market's problems and difficulties arise out of fluctuations in supply. The products of the soil are subject to the vagaries of the weather and often also of blights and pests, and though, under modern conditions of transport and the organisation of world markets, the resulting variations in output do to some extent average out, yet there remains a residue of surplus or deficiency which is unpredictable and may be large. If the market is to be prepared for a deficiency of any agricultural product, it must hold a substantial carry-over or reserve stock from each season to the next. And that means that in case of a surplus it will be burdened with a stock that may become embarrassingly large.

These seasonal troubles are peculiar to the products of the soil. But there is another source of difficulty, which is common to all natural

products. New land and new mines are constantly being opened up. The theoretical principle that the most favourably situated and productive land is brought into use first has very little practical validity.

When newly established means of transport, by road, rail and ship, give access to territory previously undeveloped, it often turns out that the new lands or mines thus brought into a favourable economic situation are more productive than a great part of the lands or mines that they compete with elsewhere. The immediate result is over-production of the commodities concerned. The market has to dispose of an increased supply, and will reduce prices. But a reduction of the price of a primary product may have very little effect in evoking an increased demand. The demand for a material used in manufacture is derived from the demand for the finished product. But only a small fraction of the price of the finished product depends on the price of the material, so that the effect on the price charged to the consumer of any concession on the price of the material is correspondingly slight. If the cost of the material represents one-tenth of the price of the final product, a reduction of 20 per cent. in the former will only allow a reduction of 2 per cent. in the latter, and that is likely to have an almost negligible effect on the volume of demand.

Thus an extension of supply of a primary product (if permanent and not a fortuitously big crop) will encumber the market with a growing unabsorbed surplus. At a time of expanding demand the surplus may after all be absorbed, but if supply continues to exceed demand and unsold stocks to accumulate, the only means of restoring equilibrium that the free market can offer is such a reduction of price as will throw a part of the producers out of business altogether.

Where it is only a product of the soil or a limited group of such products that is affected, it may be that producers can turn their land to other uses which will be sufficiently remunerative. But if it is new land suitable for a wide variety of uses that is coming into production, existing producers may find no alternative use for their land, and may be ruined. And even when the new production is limited to a single product, some land may be so specialised that it cannot be used for any other purpose—for example, when the opening up of new mines causes existing mines with high costs to be closed down.

In the nineteenth century, when railways and steamships provided cheap transport between Europe and North and South America, the European countries, finding their agriculture threatened with a crippling loss, had recourse to protective tariffs high enough to secure their farmers and peasants remunerative prices, but forgoing for consumers the reduction in the cost of living offered by the productivity of the New World. The opening up of new agricultural land has continued into the twentieth century, with similar reactions. In the nineteenth century a rapid growth of population with improving standards of living provided an apparently limitless demand for products of all

kinds, and the output of the new countries was disposed of remuneratively in spite of the obstacle interposed by protective tariffs to access to the European markets. In the twentieth century the new countries have begun to be embarrassed by their own productivity.

But that is not the whole story. When the markets in primary products have to cope with a shrinkage in *general demand affecting all products*, they find themselves burdened with accumulating stocks which reductions of price do not enable them to dispose of. And producers faced with a collapse of prices cannot relieve their position by turning over the land to some other form of production, for all products are affected. Demand cannot be expanded by reducing prices any more effectively than under normal conditions, and it may be even that for some products the supply of materials gratis would not admit of a sufficient reduction of the price to the consumer to restore demand to normal.

This state of things may descend upon the primary producers of the world like a bolt from the blue. An over-expansion of production through the development of new land or new mines is likely to be a gradual process, and to give time for adaptation. But a collapse of general demand through a monetary contraction may be precipitated suddenly and gain force rapidly. That is what happened in 1930. Even in the preceding years agriculture was depressed. Not only had there been overdevelopment, which had been aggravated by technological improvements increasing the yield of a given area of land, but there had already been a persistent monetary contraction in Great Britain, which was the greatest market for the exporters of primary products, since the return of the pound sterling to the gold standard in 1925.

The collapse of general demand in 1930 inflicted unemployment on manufacturing industry, but there was no immediate reduction of output of primary products. Prices fell and fell. Some of the countries most dependent on exports of primary products (Australia, New Zealand, Argentina and others) suspended the gold standard forthwith, but such depreciation as they were prepared to sustain in their currency units was not nearly enough to make production remunerative. The remedy prescribed by let-do, the failure of the weaker producers and the abandonment of the less favourable land, would take years to work itself out, and meanwhile prices would be so low as to cause disastrous losses to all producers, weak and strong. The low prices would be a source of gain to those in the importing countries who used the foodstuffs and raw materials produced, and might even so ease the monetary position of the industrial countries as eventually to moderate or shorten the depression itself. But in the meantime the loss and distress in the producing countries might well be found unbearable.

Alleviation was found in a concerted restriction of output. The example had been set some years before by the rubber plantations. These being confined to half a dozen countries, it was possible to agree on a limitation of their combined exports to a total to be settled from time to time in the light of market conditions, and on the proportions in which the total should be shared among them. As far the greater part of the production was in the hands of companies working on a fairly big scale, it was possible to adjust production to the permitted exports.

The depression that started in 1930 gave rise to many restriction schemes. The conditions were not always so favourable as with rubber. Brazil, saddled with coffee plantations which were inexorably producing redundant supplies, required producers to hand over a portion to be destroyed. Agriculture in the United States suffered heavily from the decline of demand at home as well as in the export market. It was not practicable to ask for a concerted restriction of output from millions of independent producers, and a system of subsidies in aid of abandoning acreage was initiated, and financed by 'processing taxes' on the products.

Restriction or destruction of output signalised a failure of competitivism no less undeniably than unemployment. It was indeed another aspect of the same failure. If there were unemployed in British, American and European manufacturing industry, and there were coffee planters in Brazil and farmers in the United States wasting their efforts on producing commodities which were destined to be deliberately destroyed, the cause in both cases was the shrinkage of demand for the finished products.

And there was another side to the matter. Tropical colonies play a special part in international trade. The great industrial countries are in the temperate zones, and depend on tropical territories, the majority of which are colonial dependencies, for supplies of products which can only be grown in a tropical climate. Under the rule of let-do, when the colonial powers allow their dependencies to trade with foreign countries without restriction, the possession of colonies (though it does undoubtedly confer important privileges on the people of the colonial powers) is not so exclusive as to jeopardise the outside countries' supplies of colonial products. Even a substantial tariff preference between a colonial power and its colonies does not have that effect. But a restriction scheme is open to more suspicion. Applied to commodities like wheat or sugar that are produced all over the world, it cannot be seriously discriminative. But applied to one which is produced only in a very limited number of tropical territories which are themselves governed under the authority of powerful industrial countries, it is evidently open to abuse.

CHAPTER IX

POWER AND CONQUEST

1. One of the distinctive features of a human community is the use of *organised* force. When one man coerces another by the threat of inflicting pain, injury or death, that is the action of an individual not of the community. When the division of labour is applied to the exercise of force by many men acting in co-operation, a far more powerful coercion can be exercised such as no single individual can resist.

It is by organised force that the community imposes discipline on its members. When it is used for this purpose, and the discipline to be enforced is in conformity with laws and customs directed to the general welfare, that is entirely desirable and praiseworthy.

Unfortunately organised force lends itself to abuse. It is directed by leaders, and the use made of it depends on their discretion. The problem of so controlling the leaders that they use their power for the general welfare is one of internal government, and we have already touched on it in Chapter III. But the use of organised force raises other problems. For whereas an individual cannot resist it, and must submit to its discipline (except in so far as he can resort to evasion or concealment), the organised force of one community may overcome the organised force of another. Internal discipline suppresses the anarchic rule of the stronger individual. Against the anarchic rule of the stronger community no preventive has been discovered. And here is the greatest source of evil known to the world. When the possibilities of organised force first revealed themselves to a group of men, well may Satan have said in frightful travesty, Where two or three are gathered together in my name, there am I in the midst of them.

Primitive communities, wielding organised force, are exposed to attack from one another. For security each must have sufficient organised force for defence against its neighbours. Otherwise it accumulates wealth at its peril. The community which is strong enough to plunder its neighbours can enjoy the products of their labour. It need not stop at robbing them of their movable wealth; if they are occupying a more eligible locality than its own, with better natural resources or amenities, it can drive them out and enter into occupation of their territory, or it can seize the population as well as the territory and enslave them. Robbery, conquest and enslavement offer so desperate a prospect that a weaker community has good reason to resist to the utmost, and in an early period of history the strong learnt the wisdom of compromising their exactions. If the

weaker community were permitted to carry on its normal life, it could be compelled, as a condition of its exemption from attack, to recognise the authority of the stronger, and to pay tribute. Even slaves have to be fed, and a community of free men, enjoying normal inducements to economic activity, would be likely to provide at least as big a surplus of wealth for the enjoyment of the conquerors as the same people enslaved.

Conquest would extend the authority of the strong community over its neighbours, and with the extension of territory and resources the strong community would grow stronger still. Once the authority of the leaders is established, and has become the accustomed source of civil discipline in the subjected community, enmity is likely to die down, and the people of the latter may take their place not only as taxpayers, but as adherents ready to share in all the national obligations of peace and war.

The fact that the union of greater numbers and of greater resources confers greater power in attack and defence supplies a powerful motive for accepting a single leadership with acquiescence, even when originally imposed by force. And union can be arrived at not only by conquest or by submission to the stronger, but by voluntary confederation.

There is thus a tendency for the merger or combination of smaller into larger political units for the sake of the additional military power attained. At the same time the extension of the region over which the authority of organised force is exercised is subject to limits, owing to its dependence on the means of transport and communications. When those limits are transcended, the big unit breaks up into two or more smaller units.

The limits are felt in two ways. On the one hand only so much of the available military force and resources as can be concentrated at a critical point can be made effective, and concentration depends on the means of transport and communications, for the purposes both of assembling the force and of maintaining it when it is assembled. On the other hand, when organised force has done its work, and the territory subjected has to be administered, the exercise of authority over any part depends on communication with the centre of government. If communications are slow or uncertain, authority has to be decentralised, and decentralisation of distant territory easily grows into separation.

The Empire of Alexander the Great was divided up after his death. The Roman Empire was held together for centuries by a magnificent system of roads, and by sea communications that had been freed from pirates. When the means of communication had degenerated, medieval Europe was divided into innumerable feudal states, and it was not till the fifteenth century that coherent national aggregates began to be formed again.

When organised force is described as the application of the division of labour to the exercise of force, that means not merely that those serving in a military force are enabled by discipline to co-ordinate their actions, but that the wealth of the community is made available for the maintenance, armament and transport of the forces. Power depends on the extent of the resources that can be effectively employed for these purposes. Numbers of men fit to fight fail to constitute force unless they can be armed, concentrated, maintained and transported to the decisive points.

2. Wealth therefore is a source of power. But not all forms of wealth. There must be reserves of armaments and equipment and of the means of transport in adaptable form. The productive power of the country must be capable of meeting the enlarged current demand for these things in time of war. And its system of transport and communications must be capable of carrying the goods required for the subsistence as well as the equipment of the armed forces from the places of production to the places where they are to be used or consumed.

A country peopled by a number of small self-supporting communities, requiring very little interchange of goods with one another, may be luxuriating in plenty, and yet be unable to supply more than a small fraction of its wealth for the purposes of war. If wealth is to be mobilised in wartime, facilities for trading between one part of the country and another must be developed in peace time. That does not mean only the physical transport of commodities. There must be traders engaged in buying and selling, and financial facilities for settling between one marketing centre and another. Indeed these trading facilities are themselves likely to be found essential in wartime. Unless the community is organised on a collectivist basis with all its wealth at the disposal of a central authority, the Government can draw most smoothly upon the available wealth by raising money through taxation and borrowing, and by using the money to pay for goods procured (if need be by requisition) through the customary trade channels.

The supply of organised force presents itself as an end of economic action; it is an alternative to the promotion of welfare. Indeed, so far as conscious action by Governments and legislatures is concerned, it has throughout history usually been the predominant end. If economists of the classical school regarded welfare or happiness as the normal end, and power as no more than an occasional intruder into the fair field of utility, that was not only because they thought that human nature would always aim at happiness unless interfered with, but also because the conditions of government in the eighteenth and nineteenth centuries hardly admitted of such far-reaching interference as definitely to subordinate individual aims and activities to military

policy. The way to increase the wealth of nations was to let the economic activity of the people fructify under the influence of demand, and to let the Government obtain whatever share it needed by taxation and by raising loans through the investment market. If enough was to be left in the hands of the people not only to provide subsistence, but to preserve the motives of economic activity unimpaired, only a very moderate fraction would remain even for the maximum effort in time of war. But this fraction probably represented as great an amount of resources as could be extracted and applied for warlike purposes in those days by any method. Therefore war meant no breach of continuity in economic life. Nor, with the simple armaments that existed before the industrial revolution, could much be done to accumulate specifically warlike equipment in time of peace. Navies and fortifications represented a considerable outlay, but fortifications were defensive, while a navy was a by-product of a merchant fleet, and could not be expanded beyond what the seafaring population could man.

Nevertheless the normal economic activities of a community could be influenced in the direction of adaptability to war, and this was always kept in view as an end of policy. The development of ocean navigation in the fifteenth and sixteenth centuries gave a new importance to sea-power. The countries of western Europe sought assiduously to develop their oversea trade, and with it expanded their merchant shipping and evolved navies. The mercantile companies and colonising expeditions received charters and privileges from their governments, and when traders from different countries found themselves competing for markets, competition grew into conflict. The commercial ventures themselves went forth armed, and, in case of a clash, could expect support from their respective governments in the form of organised force.

Oversea trade not only fostered the growth of shipping but it supplied foreign exchange in the form of gold and silver, which provided the means of drawing on foreign resources in time of war. And it generated profit. Profit-making, whether at home or abroad, was always the source of surplus wealth, to be tapped either by taxation or by borrowing. When ocean-borne trade was a novelty, it yielded disproportionately high profits. Indeed centuries passed before it became so far a matter of developed routine that its profits were confined within normal limits.

But profit-making in the home trade was likewise a source of financial strength. Profit-making arises out of the division of labour. It is in consequence of the division of labour that the products of one place within a community have to be exchanged for the products of another. Marketing centres or interposts come into being where trade routes meet, and where goods are gathered from the places of production, and despatched to places of consumption.

From time immemorial marketing centres have grown into towns. Where goods are bought and sold, profit-makers come to dwell and collect round themselves a population employed not only in assisting them in their business but in ministering to their needs. The place which begins as an interpost becomes itself also a consumers' market in which the profits derived from the interpost business generate a final demand for goods and services.[1]

It is through the marketing organisation that a Government can apply its power of raising money to tap the resources of the country in a form and under conditions permitting of their being directed to any desired purpose.

In ancient times the great commercial centres, Babylon, Tyre, Athens, Carthage, employed their resources to such effect that they could fight the great empires of their times, Assyria, Persia, or Rome, on equal terms. The conqueror who prevailed and subdued one of these great commercial states gained an enormous accession to his resources and therefore to his power.

In the middle ages it was the development of the marketing organisation, with its trade routes and interposts, that made possible the transformation of the innumerable semi-independent units of feudal Europe into a limited number of great nations. The great waterways were the principal means of transport. The Rhine, for example, gave rise to the wealthy Flemish and Dutch interposts in the region where its trade made contact with the sea, a source of wealth which has never ceased to be a bone of contention in the wars of western Europe.

Access to the sea has always been a matter of primary economic importance. When Russia's only ports ice-free in winter, being in the Black Sea, were dependent for access to the rest of the world on the narrow channels of the Bosphorus and the Dardanelles and therefore on the goodwill of the Turks, a primary ambition of Russian policy was the conquest of Constantinople. In the peace treaties of 1919 among the provisions most resented in Germany were those devised for giving the re-created State of Poland access to the sea. The German port of Danzig, through which the Vistula traffic passed, was detached from Germany and constituted as an autonomous republic under the protection of the League of Nations, and adjacent to it Poland was given a corridor of Polish territory which severed East Prussia from the rest of Germany. At the other end of Europe Bulgaria, as the result of the First Balkan War of 1912–13, was to have had a port on the Aegean. Austro-Hungarian intervention upset the settlement, and Bulgaria as a result of the ensuing war with Greece and Serbia, her former allies, lost this advantage. And as she was again on the defeated side, the loss was confirmed in 1919.

Under modern conditions the elements of economic power are not

[1] See *The Economic Problem*, pp. 98–109.

confined to these commercial advantages, but include also the manufacturing resources that can be adapted to the purposes of war. A manufacturing population accustomed to the routine and discipline of factory work is in any case valuable, but especially so if it is already engaged in those industries, such as certain branches of the engineering and chemical industries, which are themselves equipped for producing armaments.

When Germany had to give up Alsace Lorraine, the loss of a disaffected population was no great injury, but she also lost the Lorraine iron ore deposits, which supplied a great part of the material used by the German steel industry.

Germany, in seizing Czechoslovakia in 1939, acquired the country's manufacturing resources, including one of the greatest armament works of Europe. If that was to be a precedent for further seizures in Europe, what limit could be set to Germany's power? Either the other great Powers of Europe, Great Britain, France and Russia, would have to contrive to resist her or the entire resources of Europe and European oversea dependencies might be concentrated in Germany's hands.

It devolved on Great Britain and France to make a stand, and in June 1940, after the capitulation of France, there appeared to be imminent danger of Great Britain herself being engulfed.

Conquest on such a scale would have meant a concentration of resources sufficient to place a complete world ascendancy within the grasp of the German dictatorship. Not only the manufacturing resources of Great Britain and western Europe, but all their armament works and their shipping, shipbuilding, dockyards, ports and naval bases would have come into German control, along with a free run of all their oversea dependencies.

It may be said that so vast a conquest is a black but unsubstantial vision, that, whatever can be done in war conditions, one power cannot hold down populations of hundreds of millions by force indefinitely. In the long run that is probably true, but the power of repression has become terribly effective. And people must work to live. If they are placed in conditions in which their work enures to the benefit of a hated foreign rule, still they must work.

3. The acquisition of territory has not always been exclusively directed to the increase of power. Often enough economic advantages for their own sake have been the conscious motive. Sometimes a community has outgrown the means of subsistence in its own territory, and has invaded that of a neighbour to gain more living space. Or, without feeling any economic pressure or threatened distress, the invader from sheer cupidity has set out to seize territory which offers greater natural resources or other economic advantages.

Imperialism before the nineteenth century usually took the form

of private adventures of traders or colonists seeking opportunities of profit-making, either in undeveloped regions or in countries which had not shared the economic and military progress of Europe. The Governments which in the first instance confined their support to the granting of charters and trading privileges, would at a later stage carry their interference further, and would end by assuming full sovereignty over the territories in which private initiative had thus gained a footing.

Even adventures of this type were not always actuated by an economic motive. Colonies were sometimes founded, for example, to provide a refuge from religious persecution. But a colony of refugees must live, and the intending colonists had to look for an abode offering sufficient resources to supply them with maintenance. In practice refugee colonists, like traders, went in search of economic opportunities.

These economic opportunities would take the form of land values—natural advantages, either of productivity offering a supply of agricultural or mineral products, or of situation, favouring trade and communications.[1] A trader who enjoys a favourable opportunity of either kind finds his enterprise the more profitable. Natural advantages or land values, not being the product of human activity, represent no first cost or capital outlay. They enter into the productive process as a saving of cost or an addition to output without additional cost, whereas the first cost of fixed capital has to be paid for in the form of interest and depreciation. Properties the value of which includes land value are in practice bought and sold for inclusive capital sums, in which the land value and the value of structures and improvements are lumped together, and could only be separately distinguished by an elaborate and possibly very conjectural analysis. But the distinction is none the less real.

It is real in a fully developed country where the land is in private ownership and is the subject of bargains and contracts for inclusive sums, but of still greater significance in a new or undeveloped country where exploitation has to be planned on a larger scale. In a fully developed country the value of the natural advantages of any piece of land depends on the manner in which the surrounding properties have already been dealt with, the position of the centres of population, the character and lay-out of the means of communication and generally the conveniences, facilities and amenities within reach. The owner or purchaser wishing to make the most of it has a limited choice as to the manner of doing so.

But where development has made little progress, so that the future uses of large tracts of land have to be planned very nearly from the beginning, with little or no guidance or commitments from previous adaptations, the undertaking makes more searching demands on enterprise and initiative. And in such cases the exploiters can do nothing

[1] See my *Economic Aspects of Sovereignty*, pp. 14–23.

without concessions from whatever authority exercises sovereign power over the territory.

A party of colonists, settling in no man's land, themselves exercise sovereign power, whether delegated from home or set up by themselves. But adventurers who set out to exploit the resources of a region already subject to a native sovereignty have to seek concessions from the sovereign authority. Their operations will cut across whatever private rights already exist in the land, and will need the support of authority to override those rights. And, in so far as the land is not subject to private rights, the community itself (in virtue of its territorial sovereignty) will claim the rights of ownership. Thus everything they do, the enclosure and cultivation of productive land, the opening up of mines, the building of houses and other structures, the construction of roads, railways, harbours and docks, is subject to the consent of the native Government. Their legal position is governed by native law, and they are subject to taxation and administration by the native authorities.

An enlightened and stable government, with a territory offering economic opportunities which surpass the capacity of its own people, will presumably treat foreign enterprise fairly. But enlightened and stable governments are not too common, and, even where they exist, there is a risk of their changing their character. Anyone who incurs heavy capital expenditure on an enterprise in territory under an alien sovereignty is giving hostages to fortune. When the work of development is done, and he is drawing interest and profit from it, the people and with them the Government of the country will be under a perpetually recurring temptation to subject foreign enterprise to exactions and disabilities. Even if they refrain from the cruder forms of extortion or confiscation, it is only too easy with a little ingenuity to devise measures which, though ostensibly fair, will in their application deprive the foreign concessionaries of much or perhaps of the whole of the reward of their enterprise. British railway and transport undertakings in South America have suffered heavily from the refusal of the Governments to allow fares and freights to be raised sufficiently to offset the depreciation of currencies.

4. A country which has fallen behindhand in the development of its natural resources, and needs foreign enterprise and capital to develop them, is likely to be poor and weak, and a rich and strong country from which the requisite enterprise and capital are being supplied will have powerful motives to displace the existing Government, and itself to assume the sovereign power by right of conquest. It is not very creditable for a Government to be so far under the influence of capitalists and profit-makers as to engage in military adventures for their advantage. But intervention can be plausibly represented to be in the public interest, in that it will increase the country's resources, and there

are sure to be pretexts to give it an appearance of justification. Where the only semblance of government in the country to be seized is in a sparse population of primitive and possibly savage tribes, occupation can hardly be described as conquest or annexation; it is more like entering into vacant possession.

In many instances populous states with organised governments, and perhaps enjoying the traditions of an ancient civilisation have lacked the resources of modern industry and of the art of war as evolved in Europe, and have succumbed to the aggression of a European Power. That, for example, has been the history of a great part of Northern Africa and Southern Asia.

But while it was easy for the organised force of a great European power to conquer one of these relatively backward states, that did not dispose of the business. For rival powers coveted the wealth and strength to be derived from exploiting the victim's trade and natural resources.[1] It was from these rivalries that the great colonial wars of the eighteenth century arose. These were wars between the maritime powers of western Europe, England, France, Holland and Spain. Their naval and military forces, after their mutual conflicts had been decided, provided the means of subduing the local communities whose resources had been the bone of contention.

At that stage the object of policy was trade rather than the profits of exploitation, and operations were directed to settled and populous countries sufficiently weak in military power to be an easy prey. Even where there was exploitation, as in the plantations and mines of North and South America and the West Indies, from which big incomes were being brought home, trade rather than productive enterprise was the principal attraction.

The industrial revolution, setting ever greater standards of equipment for industry and still more for transport, changed this. The transition took time. It was not till far on in the nineteenth century that a quickening interest began once more to be felt in colonies.

The export of capital was far from being confined to meeting the needs of colonial dependencies. There were numerous independent countries in course of development eager to draw upon the resources of the great commercial and industrial countries to hasten the process, particularly in North and South America where the United States and the Latin American Republics had escaped from the status of colonial dependencies subject to sovereign authority in Europe. Great Britain, which led the way in external investment, found an extensive and profitable field in these countries, but for all that the vast territories of the British Empire held a special place in the movement.

In foreign countries British capitalists received concessions because they had capital. If they got a larger share of the concessions than

[1] See my *Economic Aspects of Sovereignty*, chapter ii.

other capitalists that was because they had more capital. The concessions were sometimes precarious and open to attack, if the country that granted them ever got beyond the stage of needing any more foreign capital. Much of the money placed in foreign countries took the form not of profit-making enterprises but of loans to Governments and public authorities, and that was a field where the outside investor at an early stage learnt the danger of default.

In territories under British sovereignty British capitalists received concessions because they were British. It was almost a matter of course that these advantages were kept in the family. The liberal bias of the nineteenth century discountenanced formal discrimination against the foreign capitalist or trader, but the advantage of his British rival was in practice decisive. It was not merely that the governmental authorities were prejudiced in favour of their own countrymen, but they knew more about them, understood them better, and had a better hold over them in enforcing conditions. And British capitalists were more willing to trust a British Government and were likely therefore to be less exacting on their side in the safeguards and conditions they would stipulate for. And all the time in the background was the consideration that the British subject owed loyalty and patriotism to his own country. If oversea dependencies were to be esteemed as a potential source of strength in war, it was important that their resources should be in the hands of people who would co-operate in making them available in that contingency.

The old colonial policy, that which had led to the loss of the North American Colonies and had been stigmatised by Adam Smith as worthy of a nation of shopkeepers,[1] had treated colonies as the exclusive preserves of the mother country, receiving a monopoly of a large part of their trade. So far as Great Britain was concerned, the free trade movement suppressed the exclusive system. And Lord Durham's mission to Canada in 1839 opened the way to the acceptance of complete freedom of self-government in those British dependencies which had been settled by people of European race.

These liberal institutions might have been superficially interpreted as a sacrifice of the fruits of conquest and colonisation But the fundamental link of a common sovereignty and a common citizenship remained. People from all parts of the Empire alike were British subjects. And in matters of peace and war and diplomacy the Empire was a unit.

Great Britain had already attained a predominant position in the world's trade, shipping and finance in the eighteenth century, and it was not solely on account of her oversea possessions that this position was steadily strengthened in the nineteenth. In the sphere of profit-making it is pre-eminently true that to him that hath shall be given.

[1] *The Wealth of Nations*, Book IV, chapter vii.

Special aptitudes both of situation and of national characteristics for seafaring and trade laid the foundations for a supremacy in sea warfare which opened up ever-growing opportunities for enterprise. Seapower and wealth were both reinforced as overseas trade grew.

The industrial revolution originating in British technological inventions gave British manufacturers a start over competitors, a start which was prolonged when the Napoleonic wars interrupted economic progress on the Continent, while sea power saved the British Islands from any similar interruption. The industrial profit-making of the nineteenth century, superimposed on the mercantile profit-making of the eighteenth, gave rise to the immense financial resources from which British oversea enterprise and investment proceeded.

It was not till 1880 that European statesmen began to wake up to the possibilities still remaining of colonial expansion. Great Britain had taken the lion's share, and France, Spain, Portugal and Holland had retained substantial dependencies, but the greater part of tropical Africa was almost virgin territory, and there were still parts of Southern Asia which were innocent of the economic and military progress that had been attained in Europe.

In the distribution of territory that followed, wars between rival colonising powers, such as had occurred in the eighteenth century, were avoided. The partition of tropical Africa was settled by agreement. Nevertheless in many cases military expeditions were resorted to to subdue the native occupants of the apportioned colonies, and the two Republics of South Africa inhabited by men of Dutch race and of great fighting qualities were added to the British Empire only after a stubborn war lasting 2½ years. And the colonial jealousies of the former type were revived, and on several occasions came near to precipitating a great European war.

When the war came in 1914, one of the predisposing events was the seizure of Tripoli and the Dodecanese by Italy in 1911, which broke the tacit agreement of the Powers not further to despoil Turkey, and so opened the way to the Balkan wars of 1912–13.

The war of 1914–18 was not primarily a colonial war. Nevertheless colonial ambitions were a contributory factor. Germany had received something in the partition of Africa, but her share made a very modest colonial empire in comparison with that of Great Britain, France or Holland. Voices were to be heard in Germany claiming a 'place in the sun.' The creation of a great German navy was interpreted as a step towards the fulfilment of these aspirations and therefore almost inevitably as a threat to existing colonial empires. Naval rivalry between Germany and Great Britain was certainly one of the contributory causes of the war.

In the eighteenth century colonies had been regarded as a source of trade and shipping, bringing profits to individuals and incidentally

some increase of power to the State. In the nineteenth, under the influence of let-do, their contribution to power dropped out of sight, and for a time they were even disparaged by many as an inconvenient commitment, involving awkward problems of government and of defence, and sometimes requiring distant expeditions for the exercise of force.

The war of 1914–18 set colonial dependencies in a new light. It demonstrated that modern war puts a strain on economic resources, far beyond any that had been thought of before. The economic effort had to be pushed to its limits, and among the limits encountered was that imposed by the supply of materials. Materials, whether agricultural or mineral products, are derived from the land. Those needed by any big manufacturing centre are produced over areas wide in proportion to its needs, and are transported to it to be used. The industrial development of European nations in the nineteenth century far outstripped the supplies of natural products from their own land. They became dependent on imported supplies for many materials and foodstuffs. And when their industry had to be turned over to the purposes of war, the supply of the materials required became a matter of urgent need.

Colonies helped to meet this need. Sea power, it is true, was still the decisive factor, since the belligerent with command of the sea could maintain access to neutral sources of supply as well as to his own colonies, and without it could not be sure of access to either. Indeed without sea power supplies from colonies are exposed to more direct attack than supplies from neutrals.

But colonial and naval ambitions go together. Naval rivalry between France and Great Britain survived after their wars for nearly a century, and was only ended by the Entente of 1904. The naval rivalry between Germany and Great Britain which followed cannot be dissociated from Germany's colonial ambitions.

Those ambitions were thrust into the background during the period of German disarmament. And the re-armament that began in 1933 did not include an immediate challenge either to the British battle fleet or to the British colonies, for the German programme did not allow time for large-scale naval armaments (except in smaller craft such as submarines).

Colonies had acquired a new significance as a weapon from the constitution of the League of Nations. The Covenant of the League, by way of a sanction for its decisions if resisted by a recalcitrant member, while not definitely excluding the employment of military force, looked in the first instance to a severance of economic relations with the culprit, It was hoped that this would enforce the League's decisions without a resort to war, which would be contrary to the reason of the League's being. In the absence of war, however, the

recalcitrant member could maintain uninterrupted intercourse with any country, not a member of the League, and in particular with its own colonies.

The application of economic sanctions to Italy in 1935 did more to call attention to this aspect of colonial policy than did the failure of the sanctions to detract from it, but the effect was still more in the direction of home substitutes for imported materials, such as Germany's buna rubber and oil derived from coal.

To a country retaining access to oversea supplies, the possession of colonies is in a variety of ways a source of strength in time of war. Colonies supply wealth in mobile form. When, as is usual, their products are not only exploited but transported and marketed by traders of the mother country, the interposts of the latter become centres of distribution of these products, and very likely control the business not only of re-export but of the direct export from the colonies to foreign countries. With commerce goes finance, for with the marketing business is associated foreign exchange business, and it is through the great foreign exchange centres that international investment is organised. All this combination of external commerce, industry and finance is a source of extra profit to the country's traders.

That is how Great Britain has come to be enriched. And the same organisation which found an outlet in external investment in time of peace became the means of drawing on external resources in time of war. The wealth was in liquid or mobile form, with facilities for buying and selling, lending and borrowing, as well as the means of transport, ready to be adapted to new uses.

5. Colonial expansion as understood by the modern world is a creation of the past four centuries. Conquest of contiguous territory goes back to an immemorial epoch. And here power has been the predominant motive. The inclusion in a country of an alien and disaffected population might be a source of weakness, even if their resources could be drawn on. But in general a conqueror would expect the subject peoples soon to be reconciled to his rule. The obligation of loyalty to the leader tends to attach itself to the ruler for the time being, by whatever means he may have attained that position. The transfer of the sentiment of loyalty is delayed if the displaced leader is identified with some cause transcending personalities, and a conqueror who tries to repress the characteristic culture, and especially the religion of those whom he has subjected, may find transfer long postponed or almost indefinitely withheld.

In ancient times pagan conquerors were usually tolerant enough to leave local cults and cultures free from interference. The conqueror had no great proselytising zeal, and the vanquished were quite likely to forsake the gods who had failed to save them from defeat in favour of his. When Christianity superseded paganism in Europe, religion,

within the limits of Christendom, became a unifying influence. The Reformation modified the position, and complicated it in that it not only obstructed the assimilation of a Protestant population by a Catholic conqueror and *vice versa*, but it introduced disaffection within the limits of one State. By the eighteenth century, when religious differences had been softened and toleration was spreading, the formation of big countries which aspired to the privileges of great powers had given rise to an intensified national patriotism. The loyalty of the individual to his country had by that time been divested almost entirely of its religious basis. Religion, whether in Christendom or in Islam, had ceased to be local and had become cosmopolitan, and the duties of patriotism were accorded religious sanctions only on the same plane as other duties. Yet something of the religious devotion attaching to patriotism survived. It was intensified, for example, in France by the Revolution, and the principle of nationality which grew up thereafter in Europe has always set up a man's duty to his country as something sacred. Not that it was associated with a definite cult, but that its obligations had something of the same transcendent character as those of the family.

Every country has always had to rely on these obligations to sustain its efforts in time of war, and they have had to undergo modification as the political entity forming their object has changed. The conception of the person of the leader or monarch as sacrosanct has never been quite lost. And a desire to maintain a tradition of military prowess handed down from the past has frequently contributed to it. The principle of nationality has introduced into it the idea of a community marked out by race, language and culture from its neighbours, and is perhaps best understood as a reversion to the idea of an enlarged family.

Through all these variations there has persisted the conception of a group of people linked together by a common bond of sentiment. Those so joined may be called ' adherents ' of the community, to the exclusion of those who, though resident in its territory or being of its nationality, are not animated by any such sentiment, or at any rate are not accepted among the adherents as being reliably so.

Conquest at the outset probably leaves a cleavage between the adherents of the conquerors and those of the conquered. The former assume the position of a ruling caste. So long as the conquered people retain their past loyalties, and desire deliverance and possibly hope for it, this cleavage will persist. But only exceptionally is there an insurmountable barrier. More usually the conquered peoples assume first the sentiments and then the status of adherents. That happened in the succession states of the Empire of Alexander the Great and in the Roman Empire. There were recalcitrants—the Jews, for example, playing that part in both cases. But the distinction between

the ruling caste and the subject peoples was gradually dimmed till it was finally obliterated. In the Turkish Empire the religious division kept the Christian races permanently in a state of inferiority, but even there Christians and Jews often filled positions of authority.

When conquered peoples are converted into adherents, the accession of strength to the conqueror is complete. Even when they are not, their economic resources are at the conqueror's disposal. The individual must go on working to support himself, and whatever he produces or possesses is subject to taxation, regulation and requisition by those exercising sovereign authority.

And it is actually possible to recruit military forces from a population completely indifferent to the cause they are to fight for. Unwilling recruits, who are compelled to serve, are found, once they are placed under military discipline, to be quite adequate fighting material, performing their duties and, when called on, facing hardships and perils. Only among those stubborn recalcitrants who remain actively hostile to their masters are a few found with the initiative and courage to rebel or to refuse duty.

6. Democracy introduced a complication into the assimilation of conquered peoples. The principle that every community is to govern itself is inconsistent with any right of conquest at all. It would allow no territory to be annexed by a conqueror except with the consent of the population.

But of course conquests went on in spite of democratic principles. When the conqueror on his side had no democratic institutions, there would be no difficulty; the conquered people would simply lose their political freedom. But a State which, being itself democratic, annexed territory against the will of the population, was faced with the alternatives of governing them undemocratically or of conferring on them, along with a share in the representative system, the dangerous power of interfering in the political decisions of the conquering country itself.

Representative institutions do not work well when a section of permanently disaffected people is represented. Even if they are only a small minority, their votes may sometimes hold the balance in disputed questions, and they can use this power not merely to bargain for concessions which would not on the merits be given them, but even to give vent to their ill will by introducing confusion into the political system. That danger was distressingly illustrated by the history of Irish representation in the House of Commons of the United Kingdom for nearly a century from the time of Daniel O'Connell to that of the Treaty. Racial minorities have long been a grave source of trouble in European representative systems, and religious minorities are an unsolved problem in India.

The two principles of democracy and nationality wrought big changes in the map of Europe in the period from 1815 to 1920. The

Turkish and Austrian Empires were broken up, Italy and Germany unified, and a dozen independent states constituted or revived.

But neither democracy nor nationality could be applied universally and consistently. Democracy makes exacting demands upon people's political sense and judgment. In many of the countries that adopted democratic or representative institutions in the nineteenth century, the people who received electoral power were quite unable to rise to their responsibilities. They left the business of government in the hands of a king or of a bureaucracy or of groups of politicians, and the checks and safeguards which democracy aims at applying were in abeyance. And of course there were peoples to whom even the forms of democracy were not extended. Democracy hardly existed outside Europe and nations of European descent.

The Dominions are a remarkable and characteristic growth of British democracy. They arise from that part of the colonial empire which has been settled by a population of European descent. The inhabitants have not all come from the United Kingdom. A great part of Canada is French by descent and language, and of South Africa Dutch. But French and Dutch have become adherents of the Empire and, along with their neighbours of British descent, have been accorded the advantages of parliamentary government on a fully democratic basis. The logic of democracy has gradually evolved what amounts to complete independence, the only remaining links between the Dominions and Great Britain being the recognition of the King as head of the State, the common British nationality of the inhabitants of all, and the close and binding sentimental tie which makes this common nationality a reality, in that all are adherents of a single commonwealth. The Dominions have been given the rights not only to have their own armed forces and diplomatic representation, but even to remain neutral, if they so choose, when the United Kingdom is at war, and Eire, having been accorded Dominion status under the Treaty of 1921, did so choose in 1939. The tendency in the British Empire in recent years has been in the direction of giving representative institutions even to those communities which are not of European descent. And those, such as the colonies of tropical Africa, where the native inhabitants are not fitted for such institutions, are governed as far as possible through an adaptation of their own traditional practices and authorities.

Even though the scope of representative institutions and still more that of democracy in the full sense was very limited, conquests other than those of colonial dependencies were greatly restricted throughout the century following the Napoleonic wars. The great majority of the changes of territory were in accord with the principle of nationality. The outstanding exception was the German annexation of Alsace-Lorraine in 1871. The unification of Italy and that of Germany were

on the whole in accordance with the desires of the people concerned, though the predominance of Prussia was achieved by war in 1866, and there were not wanting dissentients in the small German states which she then absorbed.

7. When the peace treaties of 1919 came to be framed, the leading principle was ostensibly that of 'self-determination,' and the new frontiers were devised with a view to satisfying the irredentist aspirations of Serbians, Roumanians, Italians, Poles and others. Unfortunately it is often impossible so to draw frontiers that there are no malcontents on either side. There must be compromises, and those nations which had been allied to the conquerors, or were at any rate enemies of their enemies, found no difficulty in weighting the compromises in their favour. There were numerous malcontent minorities, and in most of the newly constituted or newly expanded states those who exercised power were not at all inclined to forget past antagonisms and grievances. Those who had been repressed minorities in Germany or Austria-Hungary, and found that their turn had come, were only too apt to mete out the treatment they had themselves suffered to those of their oppressors who were in their power.

But, even apart from the difficulty of minorities, the principle of nationality does not assure a stable settlement of frontiers. For the frontiers appropriate to nationalities may conflict with economic or strategic requirements.

In the industrially developed countries of Europe economic policy is not mainly concerned with concessions for the exploitation of undeveloped natural advantages. Technological progress does, it is true, frequently give a value to resources previously neglected, but for the most part each country can find the means of exploitation among its own people. It is rather the established structure of economic life which may be the cause of difficulty, if frontiers fail to take account of it.

Nature and history have equipped Europe with channels of communication, with areas of industrial development and with commercial and financial centres. History has played a part as well as nature, for economic development has at all times been inflenced by political action. But on the whole nature has predominated, and economic life has had to conform to the local distribution of natural resources and feasible lines of transport.

People have to live where they work. Agricultural and mineral production disperses the working population over the land. Manufacturing concentrates them in places with convenient access on the one hand to supplies of materials derived from the land (often from overseas through a seaport) and on the other to consumers through marketing centres or interposts. Technological progress has been elaborating the division of labour for a century and a half to a degree

previously not dreamt of, and the division of labour has meant the mutual dependence of economic interests. Any obstacle that impedes the free flow of goods, whether of natural products from the land to the manufacturer, or of intermediate products from one manufacturer to another, or of finished products from the manufacturer to the consumer, inflicts loss on both sides.

The interposition of a frontier means a change of jurisdiction. That is not necessarily an impediment. The nineteenth century failed to attain the ideal of free trade, but even the relapse into tariff protection was not accompanied by other measures calculated to interfere with international economic relations. Though products sent to foreign markets had usually to pay import duties, the duties were rarely prohibitive, and the trade that could survive them was in other respects free. Investment markets were highly internationalised, and currency became international in an almost universal gold standard. Transport in Europe by rail and waterway was facilitated by international co-operation. Courts of law acted fairly towards foreign interests.

Apart from import tariffs, therefore, conditions up to 1914 were such as to make any frontier tolerable, and the actual frontiers were all the more tolerable in that they had been little altered, except by way of consolidation, for a century. The numerous new frontiers created in 1919 might have caused little economic disturbance, if economic policy had continued the liberal practice of the nineteenth century.

But of that there was never a prospect. When the ascendancy of the Great Powers of Eastern Europe was broken, the new countries which came into being were subject to every kind of instability. Their traditional animosities imposed on them disaffected minorities within their borders and hostile neighbours beyond. Coming into existence in conditions of war and emergency, they had to strain the machinery of government to deal with urgent difficulties and dangers. All suffered from monetary inflation and the resulting chaos of economic relations.

The change of jurisdiction signified by a frontier had become a far more serious impediment to economic life. The new frontiers were much criticised as creating new tariff barriers, but tariff barriers, disastrous though they might be to those whom they cut off from accustomed markets or sources of supply, were only a part of the trouble.

Property rights, trading connections, financial interests extending over frontiers became precarious. They might be affected by unpredictable states of emergency and exceptional legislative measures, by expropriations, moratoria, exchange controls, import and export quotas, and every variety of discrimination or default.

CHAPTER X

THE INTERNATIONAL ANARCHY AND THE LEAGUE

1. The State relies on its own organised force to impose discipline on its members, but no supreme organised force exists to impose discipline on sovereign States. That is the condition of things which Lowes Dickinson called International Anarchy.

We have seen in the preceding chapter what opportunities there are for the predatory use of organised force. If no cause of dispute between one community and another ever arose, a group of independent sovereign States might continue to exist in peace, each enjoying the resources of its own territory and trading with the others.

And there are many causes of dispute which are susceptible of settlement without any threat to peace. A Government exists to promote the interests of its own people, and the law by which it defines their rights is made for their benefit; when the law limits the freedom of the individual, that is in order to secure the rights of his fellows. A law so conceived provides no security for aliens. Nevertheless it is found possible by agreement between Governments to arrive at a respectable body of private international law offering a solution for any dispute regarding private rights and wrongs, which involves two jurisdictions. Custom may attain this result without any explicit agreement, as in the case of the law merchant by which international trade came to be regulated in the Middle Ages.

But as soon as disputes get beyond the limits of private rights and wrongs, and touch on policy, this happy solution fails. For whereas two States can, in virtue of their organised force, impose a decision on their respective subjects, neither can impose a decision on the other. If negotiations involving interests which are regarded as those of the State itself fail to reach agreement, and neither party is willing to give way to the other, the only way out is through the ordeal by battle; each State opposes its organised force to that of the other. There may be no stopping place short of a decision, a conclusive demonstration that one force is capable of overcoming the other. That is not invariably so, for a stage may be reached at which neither combatant sees such probability of ultimate success as would outweigh the certain loss and injury involved in a fight to a finish. A compromise peace, presumably not differing much from what might have been agreed upon without any fighting at all, is so open a confession of the futility of the resort to war that political leaders who have embarked on war are reluctant to accept it. And the alternative, a decisive victory for one side, is likely to mean much more than a settlement of the original dispute in favour of the victor. For the defeated combatant has no

rights at all against him. War wipes out all pre-existing agreements, rights and obligations between the belligerents, and the victor can despoil his victim as he pleases. He may stop short of actual conquest, but he can impose terms devised to weaken still further the State which has been proved to be the weaker,

Nor is the magnitude of the contest or the loss or suffering entailed by it restricted in any proportion to the matter originally in dispute. Both sides may hesitate to embark on a tremendous struggle in order to settle some trifling difference, when both can avoid it by accepting a compromise. But if one of the two has good ground for claiming to be the stronger, there is an advantage which the acceptance of a compromise would surrender. If agreement is to be a true substitute for a conflict, it must give the same decision as would have been reached through a conflict; the stronger party must be given substantially what he asks, and any concessions to the weaker party can be no more than an act of grace, a consideration for sparing the stronger the trouble of exercising his strength. The weaker party is compelled to acknowledge his weakness.

Thus diplomacy is fundamentally war without the fighting. Fighting is resorted to when each side claims to be stronger than the other, or at any rate when the weaker hopes to put up a resistance which may tire out the stronger. Where there is no doubt about the relative strength of the parties, *actual fighting is unnecessary*. When people are said to be coerced, what is meant is that they are threatened with injury or destruction, unless they do what is required of them. So long as the threat is known to be effective it need not actually be carried out. Even actual military operations consist of threats. One organised force threatens another with destruction. So long as it is doubtful which is the stronger, each will go on inflicting what injury it can on its antagonist. A decision is reached when, through losses or disadvantages of position, one side can no longer oppose an effective resistance to the other, and the successful combatant is in a position to put his threats of destruction into full effect.

In days of barbarism the victor would enslave or massacre his defeated enemies. But, even apart from the humane promptings of man's nature, experience has taught that clemency to captives is wise. The prospect of frightfulness provokes a desperate resistance, which may cost the victor heavy losses, or may even—such is the chapter of accidents in war—endanger his ultimate success. If the surviving members of a defeated force can look forward to returning, on the restoration of peace, to their normal lives, they will be the more willing to accept defeat. The actual amount of fighting involved will then be no more than is necessary to show decisively which side is the stronger.

Just as an army surrenders when the power of the enemy to destroy

it is demonstrated, so a nation will yield if involved in a dispute with one that is demonstrably stronger. If the army has been put into the field at all, it is its duty to fight, and to do what it can to destroy the enemy or at any rate to resist attack before giving in. An actual conflict must be joined and the army's full strength exerted before a decision is accepted. Fighting is the reason of the army's being. But a nation challenged by one of admittedly superior strength may yield without any fighting at all. And here also moderation in the terms offered is the path of wisdom. Even when territory is annexed, the change of government may be so adapted as to make but little difference to the life of the ordinary citizen, who has no political ambitions. Or a hegemony or suzerainty, which subjects the foreign policy and organised force of the weaker country to the control of the stronger, will leave the internal government of the former free from interference.

Thus even treaties and agreements reflect the relative power of the parties. Nor is a treaty which concedes something to the weaker any real safeguard against further encroachments. The stronger party need not wait for a pretext. He can propose a revision of any treaty or agreement at any time, and, if negotiations do not take the course he wishes, he can resort to threats, and eventually insist on the desired changes.

An international system thus recognising no ultimate principle except force is unstable. The weaker countries enjoy their rights and possessions on sufferance, and will be exposed to progressive encroachments by the stronger. Every encroachment makes the victim still weaker, and less able to resist the next.

2. How then is stability to be reached? One solution is the pushing of the encroachments to their logical limit and the absorption of all into a single great Empire. The Roman Empire was an example, including as it did all the civilised communities within reach, at a time when a world-wide empire, or even one extending over the contemporary civilisations of Europe and Asia, was not physically possible.

But that is not the only solution. There may be evolved a group of Great Powers, among which there is no such inequality of strength that any one of them can dictate to any other. That state of things does not merely protect the Great Powers from one another's encroachments; it protects the weaker countries from encroachment by the Great Powers themselves. For any such encroachment may unduly increase the resources of the Power venturing upon it, and will lead one or more of the other Powers to intervene.

Here we have a balance of power as a principle of stability, tending to preserve the international system from change except such as can be carried through by agreement among the Great Powers.

Lowes Dickinson's description of the international system of the

world as international anarchy was only too near the truth. The independent sovereign states of the world constituted a formless aggregate, subject to no legal or moral restraints. Nevertheless the balance of power introduced a semblance of government, which differentiated the system from mere jungle. The restraining force was nothing better than the mutual jealousies of the Great Powers. But so long as each of the Great Powers was prevented by fear of the rest from using its strength for its own aggrandisement, a moderating influence was introduced into all international negotiations.

Sometimes, it is true, the Great Powers would meet in conference rather to share plunder than to prevent it. The Congress of Berlin in 1878 not only restricted the Russian demands from the defeated Turks, but also gave Cyprus to Great Britain and Bosnia and Herzegovina to Austria-Hungary by way of compensation.

The partition of tropical Africa in 1885 and subsequent years illustrates the same principle. And in any case the balance of power, as an organisation for preserving peace and preventing aggression, always worked imperfectly. A Great Power would often find an opportunity of gaining something for itself without any danger of intervention from the rest. If only one among them were so far concerned as to intervene, this single Power would hesitate to provoke a struggle of which the outcome would be doubtful. If it drew back, the encroachment would be acquiesced in; if it pressed its intervention, there would be a war between two of the Powers, and the balance of the whole system might be modified by the result.

The balance of power is apt to be complicated by alliances among the Powers. Sometimes, when one has become either dangerously aggressive or dangerously powerful, the others or some of them have allied themselves together to resist it, as Holland, England and Austria combined against the France of Louis XIV, or as coalitions were repeatedly formed against Napoleon. Sometimes two or more Powers, finding themselves free from any serious mutual rivalry, have allied themselves together and agreed to support one another's ambitions. Such an alliance being more powerful than any one other Power, evokes rival alliances among the others by way of defence. So the balance of power is maintained by groups instead of by single Powers.

That was so at times in the eighteenth century: not however in the nineteenth. There were alliances for special purposes, such as that of France and Great Britain in support of Turkey against Russia in 1854, and that of Prussia and Italy against Austria in 1866. But till Bismarck called into being the Triple Alliance of Germany, Austria-Hungary and Italy along with his re-insurance treaty with Russia, as a safeguard against a French war of revenge, groups of Powers linked together by continuing alliances did not appear. The Triple Alliance

in the absence of any rival group did not maintain any close cohesion or systematic diplomatic co-operation,

There developed a 'Concert of Europe,' a practice of settling international affairs by parleys among the Great Powers, in which all were desirous of avoiding acute grounds of dispute. The Concert of Europe worked tolerably well so long as the Powers did not form themselves into rival groups. But Bismarck left office in 1890, his re-insurance treaty with Russia came to an end, and the Franco-Russian alliance of 1893 proved to be a move towards a permanent grouping. The Anglo-French Entente of 1904 completed the change. From that time all the European Powers were parties to a dispute which affected any of them.

Even so the Concert of Europe did not altogether cease to work. Both groups of Powers respected the balance of power, and neither side was willing to precipitate a conflict if a peaceful settlement could be found to satisfy both. Morocco crises and Balkan crises were successfully steered through.

But the latent antagonism of the two alliances remained. The Franco-German feud remained alive, German colonial and naval ambitions were a palpable threat to Great Britain, and the sources of trouble in the Balkan peninsula had only been partially and temporarily stopped. These were in the eyes of the Powers concerned vital interests. Particularly the last-named. For Serbian national ambitions had been awakened by the success of the wars of 1912–13 against Turkey and Bulgaria, and the presence of many millions of Serbians and kindred races in Austria-Hungary might well lead to a complete disruption of the Austro-Hungarian Empire and the secession of other disaffected nationalities. That would mean the destruction of the Triple Alliance (in which Italy was a weak and doubtful member) and the isolation of Germany.

Under the shadow of these potentialities of conflict there developed an intense competition of armaments. According to the standards of the total war of the present day the efforts of the Powers in that direction in the years preceding 1914 seem very moderate. Nevertheless the strain was felt, and some at any rate of the competitors were doubtful whether they could keep it up indefinitely. They were therefore in the mood to resort to war when the assassination of the Archduke Francis Ferdinand at Sarajevo brought the question of Serbian national aspirations to a head.

3. The defeat of Germany and her allies consummated the break-up of the Austro-Hungarian and Turkish Empires and brought to an end the balance of power which had governed the course of international affairs for ten years up to 1914. For the time being the re-entry of Germany into the system was precluded by the drastic disarmament imposed upon her. The vast British army that had been built up in

the four years of conflict was demobilised and its armaments and equipment disposed of, and the pre-war policy of a limited voluntarily recruited force was resumed. Revolutionary Russia had sufficient force to repress the resistance of her own rebels, but not to defeat the Poles or to retain her Baltic Provinces or Bessarabia. France and Italy remained as military Powers with conscript armies. France held the leading military position beyond dispute. And she further entrenched herself by means of military alliances with the countries which had been created or enlarged from the territories of the Austro-Hungarian Empire, Czechoslovakia, Jugoslavia, Roumania and Poland. President Wilson had contemplated a joint British and American guarantee of the security of France, but this fell through owing to opposition in the United States expressed through the vote of the Senate. Nevertheless, even without American support, France applied to Germany something like the encirclement which Bismarck had formerly applied to France.

There was potentially a balance of power, even though a disarmed Germany was excluded from it, since there were still Great Powers no one of which could overawe any other. But the Peace Treaties embodied a new departure, which aimed at eliminating power politics from international relations. That was the League of Nations.

The Covenant of the League recognised the special position of the Great Powers. For though in the Assembly each nation had one vote and only one, the Great Powers, Great Britain, France, Italy and Japan, had permanent representatives on the Council along with a limited number selected from all the other countries, and some of the most vital decisions could only be taken by the unanimous vote of the Council. Nevertheless the Covenant did assign more weight to the smaller countries than they would carry either in war or in the potential war which constitutes diplomacy. It ran counter to the principle of the balance of power, and in the event of a Great Power or, still more, of a combination of Great Powers being overruled in any important interest by their votes, the system would inevitably prove to be unstable.

So long as the Great Powers acted in harmony, the League would work. There was no likelihood of concerted opposition from the smaller countries. But at the outset not only Germany but the United States and Russia were outside the League. Germany was admitted to the League in 1926, but gave notice to leave it in 1933, and Russia did not enter it till after Germany had rejected it. At no time did the League really embody the united action of all the Great Powers even of Europe.

For all that, the League did function on the whole successfully up to 1931, when the seizure of Manchuria by Japan caused the first important cleavage among the Great Powers represented in it. The Covenant of the League provided for an appeal in any case of a

threatened international dispute, and it provided machinery for settlement if possible by consent. But, failing consent, the League would itself adjudicate, and the Covenant provided that if either party refused to accept the League's decision and resorted to war, the recalcitrant should be subjected to sanctions.

The Covenant did not exclude the use of military force against a recalcitrant, but, as it was interpreted, did not positively require it. All that was actually obligatory was the application of economic sanctions, the severance of all economic intercourse with the offending country. The use of military force was extremely repugnant to the founders of the League. The war of 1914–18 had been represented as a 'war to end war,' and the statesmen of 1919, fresh from its horrors, could not put the use of military force in the foreground of the instrument that was intended to realise this ideal. The defeat of Germany was regarded as partly attributable to the economic blockade which had eventually cut her off from all external sources of supply of warlike material and of the means of subsistence, and it was hoped that a similar measure might prove decisive against any future aggressor who might defy the League.

That was a fatal miscalculation. Had the League included the whole world, and had an economic boycott been loyally and effectively observed by all, the result might have been decisive at any rate against a country dependent on importation for any vital supplies. But so long as the United States was outside the League (to say nothing of other important countries) there was little prospect of success. Possibly economic pressure might have turned the balance against an aggressor in a conflict where there was no very great inequality of power between the combatants, but that case never arose. When the crucial test came in 1935 in the shape of Italy's aggression on Abyssinia in defiance of her undertakings under the Covenant, the obligation to impose economic sanctions was clear beyond question. But the existence of sources of supply outside the League (particularly of the vital commodity, petroleum, and its products from the United States) prevented any but a very partial blockade. And even within the League France, under M. Laval's Government, for which a good understanding with Italy was a primary object of policy, was very half-hearted in applying sanctions. Moreover it was almost certain that the application of really effective sanctions, such as the closing of the Suez Canal to ships bound for the scene of war, would provoke armed resistance on Italy's part, and start a state of actual war between her and the countries representing the League. Signor Mussolini could not have afforded to accept defeat without a trial of strength. The burden of the conflict would have devolved on Great Britain, with very little assistance from France or any other country. After fifteen years of easy-going optimistic limitation of her armaments, Great Britain could only enter

upon such a war with some misgiving, hardly with doubt of its ultimate outcome, but with apprehensions of the arduous and protracted conflict which unreadiness portended.

But in any case the extension of the Italian attack on Abyssinia into a war between two Great Powers would itself have been a disastrous failure for the League, the primary function of which was to prevent such wars. That does not mean that the war in Abyssinia itself was unimportant. It brought its tale of horrors, as well as forming a precedent for aggression and breach of faith. And it may be that an intervention in force against Italy was the duty of the League under the Covenant. But this choice of evils was itself fatal evidence of the League's failure. For the success of the League really depended upon united support of its principles by the Great Powers. The rejection of those principles by one of the Great Powers anyhow meant failure. Japan had already successfully defied the League by occupying Manchuria in 1931 and detaching it from China. The discredit was great, but the failure could be attributed to a want of co-operation between the League and the United States, without whose help sanctions against Japan would have been ineffective, and how far, if at all, this was the fault of the League was a matter of controversy.

On the other hand, the accession of Germany to the League had been a gain which the defection of Japan did not offset. The willingness of Germany to come was as important as the willingness of her ex-enemies to welcome her. But unfortunately, before the Abyssinian crisis broke out Germany had come under National Socialist rule, and had already seceded from the League.

Economic sanctions against Italy failed. Her operations against Abyssinia were neither weakened nor retarded sufficiently to prevent their successful outcome in the conquest of the country. And they gave rise to an Italian grudge against the Powers that had imposed them, and an animosity against the League and its aims and aspirations, no less than would have resulted from actual war.

4. The consequence, only too obviously, was to turn Italian policy towards Germany. Instead of 'encircling' either Italy or Germany, the European system was to revolve round an Italo-German 'Axis.' Far from being in a position to overawe occasional recalcitrants, the League was now faced with a combination against which the forces that it had the power to assemble could in case of a conflict at best hope to fight on equal terms. To say that the principle of the balance of power had been revived was an understatement of the change that had revolutionised international relations. For German rearmament on a gigantic scale was in full swing. By 1936, when the Italian conquest of Abyssinia was completed, and the economic sanctions were withdrawn, German rearmament had already reached such a stage as to imperil the balance of power itself. Great Britain and

France set to work to make good lost ground, but at no time up to the actual outbreak of war in 1939 had they gained sufficient strength to challenge the Axis successfully. Over and over again their diplomacy exposed their weakness.

German resentment at the terms of peace imposed in 1919 may be understood and indeed sympathised with. The peace was dictated to them. Had the German forces surrendered unconditionally, a dictated peace would have been legitimate, though not necessarily advisable. But the armistice of 1918 had been expressly governed by the conditions laid down at the beginning of that year in President Wilson's Fourteen Points, subject only to modifications stipulated for in the communications immediately preceding the armistice.

The Treaty of Versailles purported to be an interpretation of the Fourteen Points, but it was an interpretation so distorted that its ostensible compliance with the terms of the armistice was derisory. The territorial settlement in Europe, whatever its anomalies, could perhaps be defended as not actually contrary to President Wilson's pronouncement. But there were three matters in which a breach of the conditions agreed upon was but thinly disguised.

The most shameless was the claim for 'Reparations.' It was a condition of the armistice accepted by Germany that the conditions of peace should go beyond the Fourteen Points, in that Germany should pay compensation for the loss and damage inflicted by her aggression on civilians and their property. The Treaty defined this claim to include the separation allowances paid throughout the war for the support of the families of soldiers on active service (since the families were civilians) and the pensions paid to disabled soldiers (since they became 'civilians' when they left the army). The distortion of the plain meaning of words could hardly go further. The claim thus swollen reached the impossible total of 132 milliards of gold marks. In the end the amount extracted from Germany was hardly sufficient to cover the legitimate claims that would have come within the armistice formula, such as the cost of reconstructing the devastated areas in France and Belgium, and of replacing the merchant ships sunk by German submarines. But the extravagant claim originally made was none the less indefensible. And it was not reduced till long after it had contributed materially to the wrecking of the German monetary and financial system in the years following the war.

Secondly, the fifth of the Fourteen Points promised a 'free open-minded and absolutely impartial adjustment of all Colonial claims. . . . The interests of the populations concerned must have equal weight with the equitable claims of the Government whose title is to be determined.' Whatever that meant, it could hardly in fairness be carried into effect by taking all Germany's colonies away and handing them over to the victorious Powers. Germany had not been conspicuous

in the past for disinterested administration of colonies, but her standards had not been demonstrably lower than those of other colonial Powers. The Treaty did indeed make a highly significant and very hopeful new departure in placing the former German colonies under mandates. The mandatory Power was put in the position of a trustee for the welfare of the inhabitants of the colony, and was made responsible to the League for the due discharge of its trust. It was also precluded from giving its own people preferential trading privileges as against other members of the League. But it still had the advantage of appointing and controlling the people who administered the colony, and of regulating its development. That meant in practice that concessions and opportunities of exploitation were to a great extent reserved for the mandatory Power's own people.

The mandatory system was in principle a great step forward. The trusteeship which it defined might with advantage be applied to any colonial dependency. But the open-minded and impartial adjustment of colonial claims promised by the Fourteen Points required a settlement that would not discriminate against Germany merely as a defeated enemy. It might even be said to require the same mandatory principle to be applied to the colonies of the victorious Powers, but at any rate Germany was entitled to share in the responsibilities and advantages of the mandates. If the victorious Powers wanted to exclude her, as unfit to govern colonies, they ought not to have accepted this part of the Fourteen Points without comment.

Thirdly, the Fourteen Points promised a general limitation of armaments. The Treaty imposed a drastic limitation of German armaments, but relegated to future agreement any limitation of the armaments of the victorious Powers. The preamble of the clauses relating to German disarmament read: 'In order to render possible the initiation of a general limitation of the armaments of all nations, Germany undertakes strictly to observe the military, naval and air clauses which follow.' The operative effect of this preamble is to be found in Article 8 of the Covenant of the League, which was part of the Treaty, and which required the Council, 'taking account of the geographical situation and circumstances of each State,' to formulate 'for the consideration and action of the several Governments' plans for the reduction of their armaments 'to the lowest point consistent with national safety and the enforcement by common action of international obligations.' These limits were to become binding *after* being adopted by the several Governments.

Thus it was left to each Government to decide whether the plan submitted by the Council for the reduction of its armaments was consistent with its 'national safety,' and that in effect deprived the article of any binding force.

Nevertheless the obligation upon the victorious Powers, when they

accepted Germany's surrender on the terms of the Fourteen Points, remained binding, Treaty or no Treaty. And, apart from any obligation, high hopes had been excited all over the world for a genuine reduction of armaments.

The League moved slowly. In 1925 a Preparatory Commission was appointed for a future Disarmament Conference, including representatives from outside the League of the United States and Germany, but not of Russia. Russia had been invited, but refused. (This was the time of the Locarno Treaty, with its mutual guarantee of frontiers in the west by France, Great Britain, Germany and Belgium, and Germany joined the League in 1926.)

A limitation of naval armaments proved a manageable affair. Indeed it had already been agreed between the principal naval Powers, Great Britain, the United States and Japan, in 1922, and a new agreement was arrived at on the subject. Naval power was measurable in terms of ships, and the clandestine construction of ships in contravention of a limiting agreement was not seriously feared.

But almost insuperable difficulties were experienced in devising a plan for the limitation of land and air forces. It was not till 1932 that a Disarmament Conference actually met, and even then the Preparatory Commission had failed to produce the materials of a plan that would both be effective and secure agreement. A loose and imperfect plan might have met the need had the nations been able to rely on one another's good faith. But the opportunity for such a settlement had already passed. The French and British delegations attended the Conference with documentary evidence of Germany's clandestine rearmament in their secret files.[1] The plan could not take good faith for granted; it would have to be strictly defined in every respect, and to include an organisation for supervising the armaments of the participating countries in order to detect any infringement.

In spite of all the difficulties real progress was being made when Hitler acceded to power in January 1933. A workable scheme was fairly in prospect, which would apply an impartial standard alike to a rearmed Germany and to the other Powers. France, it is true, was at no time satisfied that her security would not be threatened, and it is a matter of conjecture whether a settlement could have been reached had the Conference been permitted to continue its work.

But of course the appearance of Hitler swept all prospects of a settlement away. Germany gave notice to leave the League, and negotiations were at an end.

When this ominous intervention occurred, the outlook for a happy and peaceful settlement with Germany had made appreciable progress. Agreement on the payment of Reparations had been reached in two

[1] See *The Whispering Gallery of Europe*, by Major-General A. C. Temperley, p. 221.

stages (the Dawes Plan of 1924 and the Young Plan of 1930) on terms which might be understood as putting no greater liability on Germany than had been contemplated by the Armistice terms. And that involved no humiliation or stigma, since the fortune of war had almost completely spared Germany the destruction of property, which it had inflicted on her victorious enemies. Even had the war ended in a draw, it would have been quite equitable for Germany to contribute to the cost of reconstruction. And even these reduced payments had been suspended at the Lausanne Conference in 1932, a sequel of the Hoover moratorium which was proposed on the occasion of the German financial crisis in 1931.

The question of the former German colonies had not been raised, but the British Government at any rate, in carefully worded pronouncements, had left the way open and unprejudiced to negotiations on the subject.

The territorial settlement established in Europe by the Treaties of Peace remained untouched (except in so far as certain of the victorious Powers had added to their spoils by seizing some coveted places that had not been assigned to them). Germany had perhaps less ground for resenting this settlement than either Bulgaria or Hungary. But the detachment of Danzig and Memel, even though they were not placed under the rule of an alien race, was sorely felt, there were numerous German minorities in Poland, the Polish corridor broke the continuity of German territory, and finally, the idea of a union with Austria, the German-speaking remnant of the Austro-Hungarian Empire, was an aspiration which the Treaties forbade.

There was little apparent prospect of having these grievances remedied by consent. The prohibition of union with Austria was a precaution against Germany becoming too strong. So was the western frontier of Czechoslovakia, which was strategically and tactically strong, but placed a million and a half German-speaking people under Czechoslovak rule. The Little Entente, composed of Czechoslovakia, Roumania and Jugoslavia, was in alliance with France, and of these Czechoslovakia was the most powerful, having inherited the principal part of Austrian industrial resources, including the great armament works of the Skoda concern.

5. But it was not rancour and bitterness arising from the Peace Treaties that destroyed the liberal Republican Government by which Germany had been ruled since 1918. The cause of the catastrophe was economic distress. The tale of ruin started with the inflation of the years 1921 to 1923. The pent-up inflation that was let loose in 1919, reduced the German mark to one-fifteenth of its original value[1]

[1] That was its purchasing power in terms of commodities. Its value in terms of gold or U.S. dollars fluctuated violently as the monetary conditions and price level in the United States fluctuated.

in 1920, and it might perhaps have stopped there. But after a precarious recovery the demands made under the Reparation Clauses of the Treaty in the spring of 1921 started a headlong monetary collapse which soon got utterly out of control, and eventually reduced the mark to one-billionth of its original gold value.

Economists have always striven to eradicate the naïve popular identification of wealth with money, but have never succeeded in doing so. It is in the form of money that the wealth-seeking motive presents itself. And after all wealth itself is no more than a means of welfare, and is misconceived as an end. Economic calculations and transactions have to be made in terms of money, for money supplies the unit for the measurement of wealth, and dissociated from it wealth is an elusive and equivocal concept. Consequently a complete collapse of the monetary system has a shattering effect on the economic fabric of society. The familiar motives on which economic activity depends are suddenly changed from firm ground into a quicksand. All is doubt and confusion. There are violent reversals of fortune. Even the quickening effect of expanding demand and rising prices upon industry is lost, when the money in which producers are paid cannot be trusted to retain its value for a day.

In the years 1921–23 Germany had to undergo this ordeal in succession to that of final defeat in the most sanguinary war known to history. There followed a phase of relative quiescence and recuperation which, had it continued for a generation, might have worked a cure. But it was interrupted by the depression which began in 1930.

Germany had not been free from unemployment ever since the collapse of the mark in 1923, though at no time was it very severe. But the depression of 1930 struck the country with redoubled force. In the first place Germany had been importing capital. The inflation had left German industry and trade desperately short of working capital, and the shortage was made good by means of money borrowed in London, New York, Paris and smaller centres. This external support gave the country, for the time being, a balance of payments which was not unfavourable. When deflation on a world-wide scale extinguished profits and dried up the sources of investible funds in the lending countries, Germany had to suffer a double dose of deflation, having to correct the adverse balance arising from the cessation of her external borrowing, and at the same time to keep pace with the rapidly falling price level in terms of gold. The deflation was only too effective. There resulted a frightful increase of unemployment, the number of unemployed at one time reaching six million. The fall of prices soon undermined the solvency of German traders, and their embarrassment in turn brought down the banks. The financial crisis of June 1931 saw the entire banking system of the country in a state of suspension.

Emergencies call for remedies, but for this no one could find a remedy. The monetary character of the catastrophe was not generally recognised, and even so far as it was, the remedy that it pointed to, a depreciation of the currency, could not be proposed to people to whom the memory of the inflation of 1921–23 had become an obsession. Never were statesmen more helpless. Unemployment, the persistence of poverty in the midst of plenty, the paralysis of the productive resources of the world when needs were as clamant as ever, seemed to be a fundamental breakdown of the economic system. Here was an opportunity for any extremists who advocated sweeping away the whole discredited system in favour of something new. The elections of September 1930 were a portent of a revolutionary turn in German politics ; the gains of Communists and National Socialists were large, though for the time being the constitutional parties, if combined, still formed a majority of the Reichstag. The economic distresses of the country grew apace, and impatience with the failure of successive governments to devise any plausible remedy brought rapidly increasing support to the extremist parties. It was this crisis that gave the National Socialists their opportunity. Their appeal had two decisive advantages over that of the Communists. They did not carry their 'socialism' to the length of seeking the abolition of the private ownership of capital, and they repudiated cosmopolitanism in favour of an intensified German patriotism. If the choice were narrowed to one between the National Socialists and the Communists, property-owning Germans and patriotic Germans had no hesitation in preferring the former, and in the end it was actually an alliance with the Nationalist or Conservative party, the party of the Junkers or squires, that gave Hitler the reins of power.

6. The dictatorship of a party modelled on the precedents of Lenin's Communism and Mussolini's Fascism, supplied a discipline which penetrated into the remotest recesses of the community. Germany was converted into a single organised instrument ready to be directed to any purpose that might be chosen by the leader who was to wield it. His chosen purpose was the creation of overwhelming military force and the reversal of the defeat of 1918. Economic depression he would overcome in his stride. The old economic system, depending on the embodiment of demand in the offer of money to evoke economic activity, had broken down ; the new system had a short cut for setting people to work ; it could just tell them what to do and leave money to look after itself.

That meant opening the door once again to inflation, not merely to such a depreciation of the monetary unit as might have restored activity in the early stages of the depression, but a recurrence of the ungovernable inflation that was rightly dreaded. But the new discipline afforded the means of guarding against that danger. Trade unions were suppressed, and wages stereotyped at their existing level.

The former regime had introduced in 1931 a foreign exchange control which prevented a flight from the currency and ostensibly preserved the old parity in rates of exchange. The National Socialist Government used this control as an instrument for the regimentation of industry. Its power on the one hand to regulate imports both of competitive products and of the materials of industry, and on the other to control the proceeds of exports, enabled it to regulate very nearly the whole of German industry. It used its power to direct industry above all into those activities which would prepare Germany for war. Incidentally industrial concerns could be compelled to employ redundant labour and so to reduce the visible total of unemployed. But the exercise of this power was not really necessary. For the National Socialist Government embarked on a gigantic armament programme involving an expenditure which transcended ordinary fiscal expedients, and which was financed mainly by additions to the floating debt, with inflationary effect. The national income expanded from 46 milliards of marks in 1932 to 70 milliards in 1937, and the number of unemployed rapidly diminished. By 1937 unemployment had ceased to be a problem, and scarcity of labour was becoming the difficulty.

Clandestine rearmament had already begun on a modest scale before Hitler's advent. But the National Socialist programme was something far beyond what Germany's ex-enemies suspected. Even when in March 1935 Germany formally repudiated the clauses of the Treaty of Versailles which forbade conscription and the creation of an air force, the magnitude of the plan was not disclosed. No budget was published. The yield of the revenue, swollen both by heavy new taxes and by growing economic activity, was made known, but the expenditure and the growth of the debt were kept secret.

Germany's repudiations of 1935 were passed over with a protest. Projects put forward at Geneva for making the economic sanctions, which were prescribed for an aggressor, applicable in some form to a treaty-breaking State, bore no fruit in face of the failure of sanctions against Italy.

It soon became clear that the treaty-breaking was not an isolated consequence of the breakdown of the Disarmament Conference, but was part of a systematic plan. In March 1936 there followed the repudiation of the clause requiring the demilitarisation of the Rhineland. That region was entered by German military forces, and the construction of fortifications was started.

Two years later came the seizure of Austria. Here was something more than a sequel of the failure of disarmament. It was an accession to Germany of additional inhabitants, additional resources and, above all, a frontier with new strategic possibilities. In case of war with Czechoslovakia a German force in Austria would outflank the defences of the Western frontier.

The French policy of the encirclement of Germany was visibly falling to pieces. Poland, while not terminating her alliance with France, had concluded a 'non-aggression pact' with Germany in 1934. A non-aggression pact may be read as precluding a declaration of war by one party to it on the other, even when the latter attacks an ally of the former. And in any case the pact was symptomatic of a change of direction in Polish policy. And now the Little Entente was threatened. Of the three component allies Czechoslovakia, combining a military spirit with great industrial capacity, was much the most powerful. But it had become exposed to attack, and, with Poland neutral and possibly hostile, was dangerously isolated. The military support of Jugoslavia and Roumania, effective enough for the primary purpose of the Little Entente, the suppression of any bellicose proclivities in Hungary, could do little in a war against Germany, and France was not in a position to help her ally more directly than by making a diversion on the Rhine.

France had already been looking for new support, and in 1935 concluded a pact with Russia which was in effect a military alliance. That afforded Germany a pretext for denouncing the Locarno Agreement, and so destroying yet another of the defences of French security, though a defence depending on German good faith did not in any case command much confidence.

The union of Germany and Austria was so natural a development, that it was not in itself to be unreservedly condemned. But the manner in which it was brought about was such as to arouse the gravest apprehension. It took the form of a violent military stroke, and an invasion and conquest, which were consummated in a day, and only avoided bloodshed because the invading force was overwhelming. It was not a voluntary union between two willing peoples, but an extension of the rule of the National Socialist Party and of the suppression of all other parties to a new field. The Austrians were to be subjected to the reign of terror and the repressions which had already been inflicted on the Germans themselves. And the seizure was carried through by a surprise onset without any attempt to arrive at agreement with the other countries concerned. The policy of the National Socialists was to gain their ends ostentatiously by force and not by agreement.

The loss of prestige to the Powers interested in maintaining the Peace Treaties of 1919 and particularly to France was immense. And the Germans quickly followed up their success. The seizure of Austria took place in April 1938. In less than six months the Sudetenland, the western part of Czechoslovakia, which is predominantly inhabited by people of German race and language, had been incorporated in Germany.

That indeed was not effected without negotiation, and it brought

Europe to the brink of war. A ghastly semblance of agreement was reached by Mr. Neville Chamberlain's heroic pilgrimage to Munich, but events quickly showed that Hitler had yielded nothing at all. Not only did he gain the concession avowedly made, the annexation of the territory predominantly inhabited by Germans, but the strategic points which he had originally aimed at were surrendered to him. A few months saw his conquest completed, and the resources of Czechoslovakia, including the Skoda armament works and the equipment of the Czechoslovak army of forty divisions, fell into his hands.

Underlying this series of bloodless victories had been the tremendous growth of German armaments. France and Great Britain had been left far behind. The German armament programme was kept secret, and its extent was not appreciated till the time of Munich, and scarcely even then. The inadequacy of British preparations at that juncture was painfully apparent. France had never ceased to maintain a conscript army of a strength commensurate with her population. But her population was little more than half that of Germany when enlarged by the absorption of Austria. And Germany's advantage in productive power was even greater than in numbers. National Socialist discipline turned over the vast German productive resources, particularly of the steel, engineering and chemical industries, to a concentrated effort on preparations for war. Under modern conditions the advantage of better equipment in aeroplanes, artillery, tanks and transport is decisive in any contest where numbers are anything like equal, and may well be so against a disparity of numbers that to past generations would have seemed overwhelming.

The combined productive resources of France and Great Britain for war were superior to those of Germany. But it takes time to adapt industry to a war output. Neither country had made much progress in this task before 1937. Great Britain, so far as the army was concerned, was content even up to the spring of 1939 with equipment for an expeditionary force of six regular divisions and for 13 territorial divisions. It was only within six months of the moment when war was destined to break out that it was decided to enlarge the force aimed at by 13 more territorial divisions, and to provide full equipment for all the thirty-two. German standards of armament, already high, were further raised when the military equipment and productive resources of Czechoslovakia were seized in March 1939.

If the failure of the League of Nations for a moment revived the balance of power, the rearmament of Germany was the negation of the balance of power. Supporters of the League called for a recognition of collective security, hoping that armed intervention by all States members of the League against an aggressor would be decisive. If all had been willing to arm on the same scale as Germany was actually achieving, or as Great Britain and France ultimately aspired to, and

to concert plans among their military commanders, it is possible that, when that process had been completed, security would have been attained. But even so the security would have been based on a balance of power. For so heterogeneous a collection of Powers, whatever its force on paper, could hardly expect to overawe Germany and Italy. The best it could hope for would have been the conversion of the League into a military alliance sufficiently formidable to deter Germany from provoking a war with it. Had Russia remained faithful to the League, that position could in time have been attained. It seems very unlikely that the smaller Powers of Europe would have consented to assume the immense financial and economic burdens that would have been necessary to enable them to make any considerable contribution to the balance.

Thus so long as the Axis divided Europe, there could be no League of Nations enforcing collective security; there could at best only be a balance of power. And in the event there was not even a balance of power. Germany and Italy committed their aggressions in fatal sequence one by one unresisted.

Germany's seizure of the remnant of Czechoslovakia in March 1939 opened the eyes of the world to the fact that no reliance could be placed on Germany's word, that no limit could be put by negotiation and agreement to her encroachments. The response of Great Britain and France took the form of a guarantee of the territorial integrity of those countries which were most exposed to further aggressions, Poland, Roumania and Greece. Poland especially, notwithstanding her close association with Germany, was marked out as the next victim, and acquiescence of the Western Powers in her dismemberment would have signified nothing less than acceptance of an undisputed German ascendancy, an ascendancy which would have exposed all Europe to the methods of repression which had already been applied to the Germans themselves.

7. The ascendancy of a conqueror is not necessarily a prospect to be resisted at all costs. The Roman Empire, with its combination of firm government and toleration of the subject peoples' institutions, was not merely acquiesced in but, after a preliminary period of abuses and extortionate exactions, came to be supported almost universally as a benefit. Napoleon, sweeping away the oppressive or vexatious relics of feudalism, received enthusiastic support in Italy, Poland and the minor States of Germany.

But National Socialist ascendancy is something different. It is essentially intolerant, intolerant of every rival cause, opinion or association. Its avowed purpose is to exploit ascendancy in the interest of the German nation to the exclusion of all other interests. Its instrument is the coercion imposed through the party organisation, and a police system which penetrates into the intimate recesses of

social and family life, and enforces its authority by frightfulness. It controls the vast modern apparatus of communications and publicity, not merely to suppress all expression of opinion inconsistent with its aims, but to work more positively upon human susceptibility to suggestion with an insistent stream of propaganda calculated to crowd out all ideas but its own.

Ascendancy destined for such ends could not be acquiesced in by peoples who had experienced the benefits of freedom. The world has, it is true, been only too familiar from time immemorial with the abuses of ascendancy, and they have continued down to our own time. They can hardly even be said to have been condemned by the world's conscience, unless they were carried to exceptional lengths, until the nineteenth century.

The suppression of the slave trade and then of slavery was a great step forward, and the same spirit that inspired these reforms was manifested in the principles of democracy and nationality. The principle of nationality, taken by itself, is only too apt to be perverted into one of national domination. But in the form it took in the nineteenth century in association with democracy it was a protest and a defence against domination. The defence is imperfect, for it offers no solution of the problem of minorities. As we have seen (p. 156), it may be that no frontier can be drawn between two nations that will not place a substantial number of adherents of one under the rule of the other.

Nevertheless so long as the democratic principle is accepted, that all subjects of a State are to enjoy the political rights for which they may be eligible, without regard to descent or language, the acquisition of territory inhabited by alien malcontents is not likely to be welcomed.

The acceptance of democratic principles has therefore offered the best hope of ending the abuses of ascendancy. In the nineteenth century democracy was regarded as a preserve of peoples of European descent, and it is only in the twentieth century that the extension of democratic principles to the native populations of Asia and Africa has come within the sphere of practical politics. Even now in no case have fully developed democratic institutions been successfully worked by them.

Nevertheless the growth of democratic sentiment has had a profound effect on the attitude of the colonial Powers to their dependencies. This is especially discernible in the British Empire, the component parts of which include some of the most important Asiatic and African nations, above all, India.

The mandatory system established under the League of Nations by the Peace Treaties is intended to lead up to self-government, and it is taken for granted that self-government does not mean the setting up of an autocratic monarch or dictator, but the creation of a constitutional Government based on a representative legislature.

Even where a European Power has become responsible for governing communities which have not emerged from the most primitive conditions and to which any formulated political institutions, democratic or other, would be unintelligible, modern policy is in the direction of maintaining in operation the existing customs and traditions of the village and the tribe in so far as these do not include cruel or injurious rites and practices, the toleration of which would be a scandal.

Ascendancy as practised by the colonial Powers is thus in course of being moderated and turned into a disinterested trusteeship. But ascendancy as understood by National Socialism is as crude a form of domination as the world has ever known. Its inspiration was derived from the Pan-Germanism advocated by a section of the German-speaking population of the old Austro-Hungarian Empire. Pan-Germanism meant devotion to the German nation as a great family marked out by language and descent. One aspect of its aims was German ascendancy in the Austro-Hungarian Empire itself; another was an association of the Germans of Austria with those of the German Reich.

It was during the years of his youth spent in Vienna that Hitler imbibed the doctrines of Pan-Germanism. If he detested democracy, that was because representative institutions gave other nationalities an equal share in the legislature. If he detested the Jews, that was because they infected German communities with a non-German strain.

Pan-Germanism aimed at the unity of the German great family, and, to attain and preserve unity, power was necessary. But its aims did not stop there. Power would confer not merely security but ascendancy. And, if the great family was to multiply and prosper, it must have living space. When he wrote *Mein Kampf*, Hitler argued that any prudential check on the natural fertility of the race would be undesirable because it would weaken the salutary effects of the law of survival of the fittest. At the same time he did advocate territorial expansion, in order to obtain living space. The two views are not wholly inconsistent if the living space does not at any stage become so ample as to permit too many weaklings to survive. He held that Providence could not have intended that of two nations with equal numbers one should have fifty times as much territory as the other. That pointed to the acquisition of living space by conquering territory from those countries which had a superfluity of it. He did not recommend an attack on the colonial Powers with this object, but preferred one upon Russia.

He did not contemplate the cession by Russia of remote Asiatic regions, but of parts of European Russia. But ' colonising ' European territory already populated is a totally different affair from colonising empty spaces or land sparsely occupied by primitive tribes. What

the former supplies is not living space but additional resources. And of course additional resources mean additional power.

What Hitler planned was a career of conquest, and the additional resources acquired were to furnish the means of more and more conquests. His intentions were made clear beyond doubt by the occupation of Bohemia and Moravia in March 1939. That act proved not only that his aims extended beyond the unification of territory inhabited by Germans, to domination over other nationalities, but that these aims were to be attained by a display of irresistible force to the exclusion of any settlement by agreement. Indeed, after the outcome of the Munich agreement had been experienced, it was impossible to contemplate settling anything by agreement with the National Socialists. Nor was it possible to set any limit to their aggressive ambitions. Hitler repeatedly announced that the limit had been reached, but each time a fresh aggression was sure to follow.

How was aggression on this scale to be withstood ? Former crises, when one country threatened to become so powerful as to be able to dictate to the rest, were met by a coalition of the other Great Powers. That was how the ambitions of France under Louis XIV or Napoleon or of Germany under Wilhelm II were defeated. The balance of power has had an evil name in history, because it has so worked as to involve countries not otherwise concerned in a war, and to enlarge a local conflict into one perhaps of world-wide extent. But the aggressor who has become so strong that no power exists capable of offering resistance, and who uses his strength to impose his will on all others, is potentially at war with all whose interests conflict with his, and not only at war but victorious without converting potential into actual war.

In face of such a danger none of the aggressor's destined victims can afford to remain neutral, or each in turn must be overcome, with no choice but between the agonies of military disasters and the humiliations of bloodless defeat. Collective security as advocated by supporters of the League of Nations was a revival of the balance of power ; its significance was that against an over-powerful aggressor there was to be no neutrality. But something more than an extemporised association of countries great and small, even had all been armed, was required to redress the balance against the Germany of 1939. And most of the small States, relying on neutrality, had no idea of organising themselves for war, while the Great Powers themselves were insufficiently prepared. In any case collective security never became an accepted policy; the combined power of France and the British Empire failed to check the onset of aggression, and Poland, Denmark, Norway, Holland, Belgium, France, Roumania, Jugoslavia and Greece were successively seized with all their resources.

CHAPTER XI

ECONOMICS OF TOTAL WAR

1. War is an industry. It is an industry for which every nation that provides for its own defence must find room in its economic organisation. But it is only in modern times that war has become a highly capitalised or 'thick' industry. Sea power, it is true, has always employed a relatively considerable material equipment and could not be improvised. And the standard of material equipment required for it was immensely enlarged in the latter part of the nineteenth century, when both ships and armaments were mechanised and defensive armour was introduced, so that dockyards and bases became vast industrial installations. From time to time British sea power was threatened by the rivalry first of France, then of Germany, but it always had a good start over competitors, and matched their efforts with greater efforts.

So long as armies made no use of mechanical transport, the provision of arms for them was a relatively minor part of the economic effort involved in making war. The limiting factor on the military force that a country could put in the field was the power of transporting the supplies not only of munitions but of food and clothing. There was little difficulty in supplying the amount of arms and ammunition required for the numbers that could be maintained.

Even before the development of motor transport, railway transport was beginning to modify this position. In the campaigns of 1914 a war of movement was conducted in the old style; but the static trench warfare that set in in 1915 placed each of the rival armies in touch with a railway system which could put into action at the front practically whatever arms and shells could be produced. The railways enabled the armies to use up guns and ammunition as fast as the factories could turn them out, and productive capacity became the limiting factor.

In previous wars competitivism had readily responded to the demands made by war. The Government of a belligerent country offered money for small arms, artillery, ammunition, and all other forms of military equipment, and private enterprise hastened to put its plant and labour to work to meet the demand. The prospect of profit sufficed to attract enterprise into the business. It might be that the productive capacity of some of the industries concerned was a little strained, and prices were raised against the Government. But the strain was never great enough to cause an exorbitant rise, or to threaten a serious shortage. The improved communications of the twentieth century not only enabled given numbers to consume a greater

amount of munitions, but they also made it possible to maintain greater numbers.

In 1915 the consumption of munitions was found to have far outstripped any limit that had ever been anticipated. That was so even in Germany, which had always been prepared for the mobilisation of an army of several millions. In Great Britain, where a vast army was in course of being improvised, the shortage was more acutely felt. Orders had been given at the beginning of the war on what then seemed a lavish scale, and in many cases the producers who had accepted the orders needed new or enlarged plant to execute them. When they were left to compete in the market for the necessary installations, the result was a strain on the producers of many of the things needed, and delays in deliveries. Under peace-time conditions, when industry is concerned with the vagaries of consumers' needs, it takes a little time for industry to adapt itself to meet a new or increased need, months or years according to the magnitude of the demand to be met. But a Government at war cannot afford to wait while traders make their calculations and decide how far a new and transitory demand can more profitably be met by increased output than by higher prices. The greatest output of the necessary products that industry is capable of is imperatively required, and wherever the capacity to produce any of them is not up to its due proportion to the rest that capacity must be enlarged without delay, regardless of cost.

2. In 1915 summary methods were resorted to. A Ministry of Munitions was created, which looked beyond the orders given to contractors, and exercised a control, closer and closer as the war went on, over the means of carrying them out. Capital advances were made to equip contractors and sub-contractors with plant; accountants were employed to estimate costs with a view to limiting prices and profits; Government factories were set up to take over part of the work; the distribution of materials was regulated, priority being accorded to Government work, and production for export over civil needs at home.

All this was done within the framework of private enterprise, but the result was that for the time being the profit motive was to a great extent superseded. It was not wholly inoperative. The traders who produced the goods in response to Government orders had established themselves in business with a view to profit-making, and they still looked forward to profit-making in the future when the crisis should have come to an end. But their present procedure was simply to carry out the instructions they received from the Government. They were required to place their skill and experience at the Government's disposal. The Government did not want to take over a mass of inactive plant, and to have to create an organisation to set it going. That would have been a lengthy and cumbersome business, involving delay and loss of efficiency. It was essential that the plant should be directed

by people who combined experience of the industry with a knowledge of the particular concern to be carried on. Ships for example were actually requisitioned, but also agreements were made with the owners by which the ships continued to be officered, manned and managed under the owners' existing organisation.

And not only enterprise but labour had to be made susceptible to directions from above. The trade unions had established, partly by collective bargaining and partly by their own internal discipline, usages designed to limit the amount of work to be done by the individual workman. Agreements simply limiting hours of work were not in themselves an obstacle to increased production, so long as there was no limitation on overtime. Overtime, earning pay at a higher hourly rate than work within the normal hours, was expensive to the employer, but, when the employer was allowed to charge prices corresponding to his costs, that was no obstacle. Indeed the danger was rather that there would be an excess of overtime impairing the efficiency of the workpeople, and even possibly reducing rather than increasing the total output.

The usages that seriously limited output took several forms. Workmen who were paid by piecework were often required by an unwritten law to keep down their output to a prescribed standard lest a higher output, yielding them earnings notably above the weekly earnings of those on time wages, should afford a pretext for reducing the payment per piece. In some industries the output of those on time wages was similarly restricted, partly to guard against the workmen being overdriven, and too much being exacted from the less capable, partly with the idea of spreading the available work over greater numbers in order to give employment. There were also various rules and practices limiting the recruiting of skilled grades, and reserving certain kinds of work for them, sometimes with quite insufficient regard for the amount of skill and training really needed. Finally the right to strike itself, the ultimate sanction of collective bargaining, if resorted to in wartime, would cause an irreparable loss of output, and a prolonged stoppage might be disastrous.

A Government intent on procuring the maximum possible output of the means of war was bound to get these practices suspended, and this was accomplished by agreement with the trade unions in the course of the war (though not without friction, since the trade unions were not always in a position to control their members in localities where discontent or revolutionary sentiment was active).

Thus war required a new discipline to be imposed on both traders and workpeople. The discipline did not take the form exclusively of coercion under penalty. When possible it was imposed by agreement procured by appeals to patriotism. But a background of compulsion was gradually added. The power of requisition and the control of

raw materials enabled the Government to exercise what amounted practically to compulsion on the traders. And recalcitrant workmen could in many cases be called up for military service.

In the present war measures of coercion have been carried a stage further, and use has been made of the power taken under the Emergency Powers (Defence) Act of 1940 to requisition the personal services of the individual. But in both wars it has been taken for granted that this regimentation of industry, like all the measures limiting personal liberty on grounds of national security, is no more than a wartime expedient.

In Germany, however, National Socialist discipline imposed just such a regimentation throughout the six years of peace when Germany was rearming. That is not necessarily a precedent for the peace-time policy of other countries. For Germany the period was one of virtual war. She was preparing a succession of aggressive strokes which required the direct threat of armed force, and it was almost certain that the threat at some stage would have to be carried out and would lead to an actual conflict. Moreover the totalitarian system, even in a condition of secure peace, unequivocally rejects personal liberty, and pursues regimentation as its characteristic method.

When these direct methods were used to get work done for the paramount needs of a country at war, the competitivist motive of profit-making was partially superseded. Traders had to be allowed sufficient profits to yield them reasonable incomes, but there was no longer any reason for them to gain the exceptionally swollen profits which would have been needed if the free play of competitive markets had been relied on to attract them into the desired forms of production. So far as the contractors executing Government orders were concerned, it was possible to limit their profits by express conditions, enforced by the application of cost-accounting methods to ascertain the actual rate of profit secured. But that did not dispose of the matter, because many of the contractors were entitled to expand their output not merely to capacity but to an enlarged capacity installed for the purpose, and a moderate rate of profit yielded them an inordinate increase of income. Moreover when imports and production for civilian consumption have to be severely limited, those traders who are in a position to continue their sales of the restricted goods, whether from pre-existing stocks or from such new production as is allowed to continue, may secure prices so greatly increased that their profits even on their reduced sales are enormously enlarged. In the war of 1914–18 the excess profits were further swollen by monetary inflation, which soon became indeed the most potent cause of all.

Profiteering became the object of energetic denunciation, and a partial remedy was found in an excess profits duty, which appropriated to the Exchequer at first 40 per cent. and from 1916 80 per cent. of

the excess of the profit of any trading concern over a pre-war standard.

In the present war there has been a more comprehensive control of prices, and the application of a cost-accounting system to Government contracts was started in the period of rearmament before the outbreak of actual war. Nevertheless an excess profits tax has been found desirable. Limited in the pre-war phase to excess profits derived from armament contracts, it was extended on the outbreak of war (at 60 per cent.) to all excess profits, and raised in 1940 to 100 per cent.

A tax that deprived the trader of all profit in excess of a fixed limit was found to have serious faults. For any trader whose profits passed the limit, the tax extinguished the motive relied on by competitivism not only for enterprise but for keeping down costs. The trader had no inducement to resist demands for increased wages, especially when there was a scarcity of labour, and men could be attracted away from less highly paid employment. The regulation of prices itself was confined to limiting any rise of price to so much as a rise of costs would justify, so that prices tended to go up automatically with wages. In 1941 the tax was modified. The trader still had to hand over the whole of his excess profits, but one-fifth of the amount was treated as a forced loan, and credited to him for repayment at a future post-war date. The net ultimate burden of the tax was thus reduced to 80 per cent. of the excess profits.

A drastic excess profits tax, depending on a pre-war standard of profits, is essentially an emergency expedient. For the duration of the emergency it partially suspends the profit-making basis of competitivism. If it is levied at 100 per cent. it approximately stereotypes the pre-existing structure of traders' incomes, and takes for granted the continuance of enterprise on that basis. But if the tax remains operative for any prolonged period of time, it has to be applied to new and reconstructed enterprises, which have no standard profits to start with. The rough and ready measures of a war emergency meet that requirement by basing the standard for a new business on the capital employed in it, assuming a certain percentage of the capital to be a fair rate of profit, and charging anything in excess of that percentage as excess profits. But there is by no means a uniform relation between profits and capital, and for the purposes of fiscal administration there are almost insuperable difficulties in the way of assessing fairly the value of the capital employed in a business. A new excess profits tax can deal with the relatively small number of new businesses in this way (especially when war conditions greatly curtail the number of new businesses that can be started, other than those brought into being for Government purposes). But as the number of businesses established since the inception of the tax grows,

and especially if the tax goes on after the emergency is past, the anomalies and complications become more and more baffling.

3. It is devoutly to be hoped that the present war will end with a real peace, in which the burden of armaments can be reduced to a bearable level. But it would be folly to be blind to the dangers inherent in the international anarchy, when every nation depends upon its own armed strength to secure its rights and interests, and the competition of armaments may raise the proportion of its resources absorbed in armaments to the utmost limit. One attempt at superseding the international anarchy has failed, and no one can say with certainty that another will succeed. If no solution is found, mankind may have to face the continuance into times of ostensible peace of economic efforts and strains little less exacting than those of war.

After the war of 1914–18 a group of victorious Powers emerged still linked together by their action against a common enemy. The enemy was disarmed, and they felt no need to take precautions against one another. There was for the time being no competition in armaments.

But even before the advent of Hitlerism in Germany, there were malcontents who began to think once more in terms of military power. Russia, having cut loose from the orbit of western Europe, set to work to create a vast new industry, planned to include the essentials for arming and equipping a great army. Italy turned to Fascism and, professing to be dissatisfied with her spoils of war, evolved a totalitarianism equipped for aggression. Japan embarked on her Chinese adventure with the seizure of Manchuria in 1931. Thus there were already three Great Powers that had repudiated the ideals of the League, and the international anarchy may be said to have reasserted its existence, before German rearmament had begun.

The same thing may happen again. The world may start the peace with a group of victorious Powers genuinely desirous of maintaining a reformed international system, and quite free from any threat to one another. But in course of time a clash of interests may arise, and a competition of armaments result.

And the recently developed capacity of the industry of organised force to absorb all a nation's available productive resources remains an inexorable fact. The competition of armaments pushed to its logical conclusion means universal economic exhaustion. It is not possible indeed to maintain continuously in peace time the concentrated effort called for by war. But an unrestricted competition in organised force, threatening any country that falls behind in the race with an irretrievable lapse into weakness, can hardly fail to evoke an effort up to the limit of what is practicable. When there is a danger of one Power or group of Powers gaining a decisive advantage, its rivals are likely to intensify their measures of defence beyond what can be permanently

sustained. That is a situation which almost inevitably leads to actual war, for to wait till the exceptional effort can no longer be kept up is to accept the position of relative weakness after all.

Here is the explanation of the manner in which the competition in armaments leads to war. When one group of competitors is for the time being successfully maintaining its power by exertions which overstrain its resources, it can only safeguard its position by attacking its rivals and destroying or at any rate diminishing their power while there is yet time.

But, even when war is avoided, the competition of armaments holds out a fearful prospect. If every country is compelled to devote its productive power up to the maximum possible limit to the maintenance of organised force, the residue of productive power left for the welfare of its people is thereby reduced to a minimum. In the years immediately preceding the outbreak of war in 1914 there were complaints that the burden of armaments was becoming intolerable. In the United Kingdom the expenditure on the forces reached about 3½ per cent. of the national income. In the principal military Powers of Europe it was substantially greater, but nowhere did the proportion much exceed 5 per cent. The proportion now to be contemplated is far higher. Germany in the years 1933–9 was spending 20 per cent. That, it is true, was met largely out of loans. But towards the end of the period much the greater part was met from revenue. And no country can allow the limitations of its fiscal system to compel it to fall behind in the competition of armaments. If the taxes necessary to raise the revenue cannot be enforced, a solution will be looked for in a change in the economic system. That must mean that in some way the State would procure the production it needs by direct action upon the productive concerns instead of by buying it in the market. But regimentation on the lines resorted to in war will not work as a permanency. It depends on profit-making traders creating the necessary enterprises before the emergency arises and looking forward to normal profit-making after it is over. The hypothesis that the fiscal system cannot meet requirements implies that the mere appropriation of a share of the profits by way of income tax, and taxes on profits, along with all the other fiscal devices, will not yield a big enough revenue. The hand-to-mouth expedient of borrowing the deficit until inflation develops cannot postpone the reckoning long. There is in fact no way out short of collectivism.

4. Collectivism has been successfully established by totalitarian methods in Russia. It was applied, in the period of the five-year plans, to industrialising the country. Manufacturing industry was equipped and started on a gigantic scale in an astonishingly short time, so short as to involve the population in serious privations. The newly established industry worked at first very imperfectly. The equipment

produced was subject to frequent breakdowns, partly through defective workmanship, partly through ignorant and unskilled use. But for all that the great transition was effected, a transition that meant the spread to Russia of the industrial revolution which had started in England in the eighteenth century. The transition carried with it the potentiality of military power. Special attention was paid to the heavy industries, steelworks and engineering, by which the armaments and means of transport of a modern army and air force are produced.

Russia supplied the model for totalitarian methods to be copied first in Italy and then in Germany. In Germany profits, though heavily taxed, were maintained in being. The tax on profits in the years immediately preceding the war reached 50 per cent. (not of any 'excess' profits but of the whole profits), and the residue was subject in the ordinary course to income tax. Dividends also were limited to 6 per cent. of capital, and undistributed profits became a forced loan compulsorily invested in Government securities. But in principle profit-making continued, and industrialists, though subjected to searching controls, remained in executive command of their enterprises.

Yet it is not certain that so much of profit-making can permanently survive under an unlimited competition of armaments. It may be found that the competing States cannot afford to leave *any* spending power beyond a reasonable salary in the hands of the industrialists. Along with the prospect of profit, the authority of the industrialist is eliminated. He must accept the position of a subordinate to the State as the sole profit-maker.

Historically communism or collectivism has been associated with cosmopolitanism. Russian communism has always aspired to be international. The Union of Socialist Soviet Republics is the union not of a territory or of a race or of a great family, but of communist soviets wherever they may be formed. Russia is a constituent republic of the Federation, and is not named in its designation. Communist parties have opposed all wars except wars for the establishment of communism, and have been the natural allies of pacifist and internationalist parties in the great questions of international policy.

But communism, whatever its history, is not essentially an international cause. A collectivist economic system may be advocated as a means of promoting the welfare of the human race. But it may also, on the contrary, be advocated as a means of organising military force. Private profit-making enterprise may be eliminated either because it gives rise to abuses and enables the recipients of swollen incomes to waste a part of the resources that might otherwise be applied to the general welfare, or because the State is engaged on some operation, such as armaments, from which it cannot spare anything for private profit-makers, or indeed for the general welfare, beyond what is in-

dispensable to keep the population fit for the work of production and warfare.

Collectivism thus emerges as the logical outcome of militarism when pushed to the extreme limit. The need for adopting collectivism is felt when the fiscal system shows signs of breaking down. The process of raising money by taxation reaches its limit some way short of the complete absorption of incomes in excess of what collectivism would permit as a proper standard of personal earnings. The practical limit is felt partly in undesirable economic reactions of unduly heavy taxes, partly in a failure to enforce taxes owing to evasion and to a resort of taxpayers to various devices within the law to escape liability, partly in an unwillingness on the part of the legislature to impose adequate taxation against popular opposition. When these symptoms become manifest, the theoretical limit of taxation, the maximum that can be raised by the most wisely framed taxes from the most willing taxpayers, may itself not be far off. When the limit, practical or theoretical, is reached, the effect is seen in a recurrent deficit which cannot continue indefinitely without causing inflation and a financial collapse. The transition to collectivism may then be the only means of concentrating the requisite productive resources in the hands of the State.

5. Collectivism does not necessarily mean totalitarianism. But it makes greater demands on the enforcement of discipline in economic life than competitivism. Totalitarianism is the omnipresent discipline enforced by a party. It presupposes a paramount loyalty to the party among its adherents. The Communist Party assumed this function in Russia, the Fascist Party in Italy, the National Socialist Party in Germany. Other countries rely on patriotism, loyalty to the country itself. That is a powerful sentiment, so deep-rooted as to be almost an instinct, but it is in many countries no more than a potentiality. To become an active force, it needs a stimulus, above all, appeals at times of visible and imminent national danger. To the citizens of a Great Power, proud of a strength which has in the past gained them great advantages, and aware that, if assailed at a moment of relative weakness, they have much to lose, patriotism is likely to be always present. Even among them patriotism is confined to the true adherents of the country, and there may be many inhabitants who, even though subjects of the State, are alien or cosmopolitan in their sympathies, or are completely ignorant of international issues and historical traditions. The loyal adherents, however, are in a position to exercise the influence of a dominant party, and, if they are sufficiently ardent and united, can keep the population as a whole up to the mark.

Among minor Powers, especially those which have enjoyed generations of quiet neutrality, patriotism is apt to be less effective. The

people may feel a genuine and very proper pride in their country, but, as they cannot hope to compete with the Great Powers in organised force, their patriotism does not easily take a military form. There are, it is true, small countries which have age-old feuds with their neighbours, and are as much preoccupied with organised force as the Great Powers, and there may be minor Powers which aspire to enter as make-weights into the balance among the Great Powers.

And even in a Great Power patriotism may decay under the influence either of cosmopolitanism or of pacifism or of the indifference that comes with peace and security, or it may be overshadowed by a rival sentiment, as when religion or Jacobinism or communism has become a cause of conflict transcending frontiers.

Some powerful sentiment there must be to reinforce the disciplinary code that has to be applied to civil life in war time. Indeed without it the armed forces themselves are not likely to show a full fighting spirit. There have been times in the past when monarchical or aristocratic Governments have waged wars against one another with professional armies for causes in which the soldiers as well as the peoples felt little or no concern. When the indifference was on both sides, the contest was fought and decided in a professional spirit, and the defeated party, after yielding the matter in dispute, retired hoping for a better result next time. But the professional armies of the eighteenth century could not hold their own against the onrush of the popular levies of the French Revolution.

The vital need for the emotional support of the people is even more conspicuous in the total war of modern times, where exhausting and sustained efforts are demanded not only from the armed forces but from the entire effective civil population.

The emotional appeal of National Socialism was to those who counted themselves Germans, the adherents of the German great family. It is not easy to say precisely what the fundamental characteristic of Germans was for this purpose. It did not include all those whose mother-tongue was German, for it excluded German-speaking Jews. Nor was it entirely a matter of race, for it excluded the German-speaking Swiss, so far as their loyalty was to Switzerland. The intention was perhaps to appeal to all people of German origin and only to leave out the unwilling. Race, however, was a very equivocal test, and the National Socialist Party did not claim racial purity for the Germans. As Herr Hitler wrote in *Mein Kampf*[1]: 'Unfortunately the German national being is not based on a uniform racial type. The Germans lack that strong herd instinct which arises from unity of blood.'

The German State was anyhow a mighty fact, and the real bond was simply the aspiration for its power and ascendancy. Apart from Anti-

[1] Mr. Murphy's translation, p. 382.

Semitism no racial test was necessary. And the uniting sentiment was not needed in any intense form in the great mass of people. The numerous and active members of the dominant party, in whom the aspirations of national ambition were combined with a lively consciousness of the dependence of their own position and prospects on the party, were able to enforce the necessary discipline. And once the restoration of German power came in sight, the patriotism of the mass and their pride in the traditions of a Great Power were revived, and the organisation of the nation's resources for that supreme purpose, even at the cost of the rigorous totalitarian discipline, with its concealed denunciations and terrifying punishments, became assured.

Russia has applied a totalitarian discipline little less exacting than that of Germany, but with two important differences. The Russian temperament is prone to laxity of administration, and though the Bolshevik party has repeatedly resorted to ruthless repression, and its secret police supplied the model for the German Gestapo, it has never attained German thoroughness. And its desire for domination (ostensibly at any rate) has been associated with the communist aims of the Third International, aims which were reputedly in the direction of human welfare (perhaps of a too materialist kind) even though the immediate means might be organised force.

When France and Great Britain became aware of the magnitude of German armaments, and the resulting menace to their own security, and indeed to the security of any country in the world from which Germany could seize anything that would contribute to her power or prosperity, they both had to face the problem of concentrating their resources on preparations for war. The problem of enforcing a more thorough discipline on the civil population did not arise in a pressing form till the actual outbreak of war. But from the moment of the German seizure of Bohemia and Moravia in March 1939, there began an intensification and acceleration of preparations for war that brought the problem into sight. And then a realisation of the gravity of the threat to national security and of the unbounded scope of German national ambitions gave a keener edge to the sentiment of patriotism. Not only was the danger tremendous and imminent, but it was only too clear that there was no escape from it other than by armed resistance. An enemy who makes a boast of breaking faith, and who regards a treaty merely as a device to gain time for an aggressive attack, offers his neighbours no prospect of obtaining security by negotiation and agreement. If they fail to make a stand, they can only look forward to being stripped by rapid stages of wealth, territory and freedom. The conquests to which the National Socialist Party aspired had never been limited to the unification of the territory inhabited by Germans, yet up to the time of the Munich Agreement of September 1938, when the annexations had been confined to Austria and the Sudetenland,

there was a hope that that limit might in practice be observed (apart from the contingent future claim to the restoration of the former German colonies). The seizure of Bohemia and Moravia destroyed that hope.

The democratic countries were ready in these circumstances to put all their strength into preparations for war, and to make whatever efforts and to submit to whatever exactions, privations and discipline might be called for.

6. If peace is potential war, and actual war is total war, can the necessary efforts and privations be imposed on the people permanently? So long as the competition in armaments continues, and each nation's security is believed to depend on its not falling behind, there is likely to be political support for the effort. If that meant the reduction of the population to a bare means of subsistence, it might well be found intolerable. At any rate it would not be worth while to undergo such an ordeal indefinitely for the sake of material possessions which could not be enjoyed; that would be for life's sake to lose life's worth. If what is at stake is not merely material prosperity, but welfare in a more fundamental sense, or the freedom which is the soil in which welfare grows, material privation is not too high a price.

But beyond a certain limit privation itself ceases to contribute to warlike strength. Not only must those who are to be chosen for military service be allowed such a standard of living as will make them fit to fight, but on the side of production, if the maximum output is to be obtained from the workpeople, they must be allowed both an adequate standard of living and adequate leisure. Long hours of work may be effective in obtaining an increase of output for a short spurt of a few weeks, but as a permanency they defeat their own object. And an adequate standard of living includes not only adequate food, but whatever is necessary for health, not only the health of those actually at work but that of the children on whom the power of the nation in the future will depend. It also includes so much cultivation of the intelligence and mental powers of the people as will conduce to their skill and efficiency, both in the conduct of war and in warlike production.

All these requisites must be provided for among the economic activities of the community, if it is not to degenerate in productive power and fitness for war. It may well be therefore that militarism will not seem intolerable to the ordinary man from the point of view of material prosperity. He who, having been wealthy, finds private enterprise and with it the source of his wealth suppressed by a collectivist revolution will complain bitterly of the confiscation. Or, if the effort falls short of collectivism, the rich man who finds that fiscal exactions leave him with an exiguous fraction of his nominal income may feel that the amenities of life have been destroyed. Yet the great

mass of the people may have suffered comparatively little visible deterioration of their standard of living.

So long as it is far-sighted, therefore, militarism is not wholly destructive of other sides of civil life. Nevertheless the grounds of policy by which the coercive constraints applied to every branch of economic activity are guided converge on the single paramount aim of organised force. People who seek for a little sport, entertainment, recreation or amenity, are allowed so much as conduces to fitness and no more. It is dangerous even to allow them to desire more, so that incitements to a fuller life beyond what fitness requires have to be repressed. Any aim in human life which becomes a rival to organised force is a possible source of weakness.

Economic activity means work, and if organised force is the exclusive end of the community's work, and people are prevented from working for any other, then all other ends will fade into ineffectiveness for want of organised effort. Human life as a whole will be desperately impoverished.

That at its best is the result of militarism, rationalised and prudent. But such a condition of things is not stable. It is not in the nature of war or of a peace that is potential war to be far-sighted. Any country or group that feels itself in danger of falling behind will temporarily push its exertions *beyond* the limits of prudence, in the hope of attacking and overcoming its rivals while the advantage lasts. The latter, if aware of this in time, will in turn increase their exertions. The competition in armaments thus tends at intervals to pass beyond the limits of prudence, and whenever that occurs, the economic strain will be intensified and potential is likely to develop into actual war.

The balance of power itself is always precarious. It depends on no Power or group of Powers being strong enough to overawe its rivals; there must be uncertainty as to which is the stronger. But relative strength changes, and a clear preponderance of power may emerge on one side or the other. Or the uncertainty may be so widened that only an actual conflict can make the true position clear, and neither side is willing to make concessions to a rival who may, after all, be far weaker. Concession indeed looks like an acknowledgment of weakness. In any case a clash of interests may arise which is incapable of compromise, and results in war, even though neither side is confident of success.

Moreover the balance of power presupposes a standard of national good faith. Disputes cannot be settled by peaceful compromises, embodied in agreements and treaties, unless the parties can trust one another.

If the balance of power fails to preserve the peace, and war breaks out, then the result may be a decisive victory on one side which destroys the balance. If the victorious side is itself a group of allied Powers,

there may soon be evolved a new balance of power, in which former allies participate as potential enemies. Or the victor may be a single Power which has formed so great an aggregate of organised force as to reduce all the rest to subjection, like the Roman Empire, or that of Alexander the Great, within their geographical limits. Under modern conditions there are no geographical limits short of the whole world.

The world hegemony of a single great Power is not *necessarily* an undesirable solution of the problem of international anarchy. If the paramount Power disarms all others, and takes adequate precautions to keep them disarmed, it can be satisfied with forces of its own sufficient to act the part of an international police, and can maintain them by taxes or tribute levied on the subject peoples.

Whether that is a tolerable settlement depends on how the paramount Power uses its position. If it pursues a course of justice and toleration, seeking to promote the welfare and liberty of the subject peoples, the loss of their independence may have little influence on their lives. But it is no easy matter to achieve this. The ultimate force behind the authority of a subject Government is that of the paramount Power, and it cannot be used blindly to support laws and decisions which that Power cannot approve. The Romans did what they could (after the first orgy of rapacity and oppression of the Republican Proconsuls was over) to observe principles of toleration and moderation. But Pilate's terrible dilemma illustrates their difficulties only too well. For the past half-century the British Empire has been striving to follow the same policy, and indeed to improve upon it by favouring representative institutions with a democratic tendency wherever the people are fit for them. But the responsibility of the ultimate repository of force cannot be evaded, and the policy of toleration only reaches its logical outcome in a sharing of that responsibility by according what has come to be called Dominion status to communities which thereby cease to be subject colonies or subject states and become independent partners. That evolution, if it occurred, would transform a world hegemony once more into a system of independent states.

Moreover experience has shown only too certainly that the unification of sovereign power in a great Empire or Federation is no sure preventive of war. The Roman Empire was racked by civil wars, and must be counted fortunate in having at one period been troubled with them only once in two centuries. So long as the international anarchy continues, peace will be potential war and the economic activities of the world will be dominated by the tremendous industry of warfare. The destructiveness of war itself is an additional economic loss. From the point of view of a community's productive power, the resources applied to armaments are just as much a loss as those applied to making good war damage.

CHAPTER XII

ENDS

1. What has been said in the last chapter may seem to presage the ruin of civilisation. If mankind is to be burdened permanently with the struggles and terrors of total war, and to enjoy no real intermission, surely that is no more nor less than the failure of human existence.

If that is failure, what would be success? Destruction and hatred are bad. Escape from them is a necessary but not a sufficient condition of a good life. If men cease to work for destruction and hatred, what positive ends should they work for?

Every human community has its moral code forbidding fraud, violence and vice. But these prohibitions are negative. And rules of conduct are means, not ends. To them, however, has to be added the rule of *kindness*. To be kind is to promote your neighbour's welfare.

Kindness includes unselfishness and goes beyond it. Unselfishness consists in allowing your neighbour's desires or purposes priority over your own. Kindness does not merely defer to his aims, but actively seeks his welfare. That is something positive, but it only takes us back to our starting point. Welfare is the end, but what is welfare?

Kindness is an attitude of mind with which we are all familiar, and by following out its implications we can give shape to that concept of welfare or the Good, which, even if it is the plaything of philosophers, is nevertheless the foundation of practical life.

Welfare is that in life which is not merely a means but an end. Kindness presupposes the possibility of a good life to be pursued as an end of action. Its essence is that we make our neighbours' good life as well as our own the aim of our conduct.

Perhaps it may be argued that welfare is an abstraction or a fiction which does not enter into the matter, and that kindness to one's neighbour need not be concerned with anything beyond helping him to attain what he *desires*, without any ulterior consideration as to whether what he desires is good. That argument does not preclude what he desires being interpreted to mean not just any object towards which his desire may be directed for the moment, but that which, if he could correctly foresee its effects upon himself, he *would* desire. That is to say, kindness would take account of the possibility of his actual and immediate desires being mistaken, and would help him rather to attain such things as, when attained, will in fact give him satisfaction. Satisfaction is a matter of fact, and does not necessarily have any ethical significance. The kindness enjoined upon us might be taken

to mean promoting one another's satisfactions, without regard to whether those satisfactions are 'good.' The utilitarian philosophy of the nineteenth century sought to explain away the moral code in terms of happiness. Happiness as an end of conduct does not differ from satisfaction; it is the state derived from a general satisfaction of desires. According to the utilitarians the rules of the moral code were the means of promoting happiness by preventing people from interfering with one another's satisfactions, and had no other validity.

But moral codes cannot be explained away. A rule is rightly a duty only if the end to which it is directed is good. Moreover kindness is not *merely* a duty; it is itself an aspiration, a desire demanding satisfaction. If it finds satisfaction in promoting happiness, that is because happiness itself is believed to be *good.*

That is not necessarily erroneous. It is possible that happiness is the simple answer to the question, What things are good?

But would it be a 'simple' answer? Happiness is no more measurable than satisfaction. It has degrees of intensity, but the only criterion that can be applied to it is that the greater may be preferred to the less. Is the greater happiness necessarily the better? The utilitarians said yes. But perhaps they assumed too much. If happiness is derived from satisfaction, surely the character of the happiness depends on the character of the desires or needs that are satisfied. It is possible that the care-free existence of a cow, with its animal needs supplied, is the greatest happiness. But that is not the kind of welfare to satisfy humanity.

But how unnecessary it is to try to explain away the notion of good in terms of something else! The welfare that the kindly disposed man wishes to his neighbour embraces any forms or all forms of good, ranging all the way from the simple animal pleasures up to those transcendent moments which are but rarely experienced, moments of a supreme human or artistic emotion, of mystical ecstasy or beatific vision.

Philosophers or mystics have been found to say that the only true end is a *summum bonum*, and that time devoted to anything less is imperfectly used. But life is not contrived in that way. There is no single experience which is the *summum bonum*. The good life can only be composed of such good as is practically attainable at its successive moments. Welfare is the good, *spread over time*. If life at one time or another has to offer a sublime climax, that is comprehended in welfare, but along with it is the good, however modest, experienced from day to day and from hour to hour.

That is the end not only of kindness but of virtue, generally. It is the right end of all human action. The rules of the moral code are means. To regard virtue as an end is a misconception. Virtue consists in *doing* good, and if good is done someone must *experience* good. That does not exclude virtuous actions and motives altogether

from the realm of ends. Action is the outcome of feeling, and the feeling which prompts a virtuous action may itself be good, as may the response of those who appreciate or admire it. But it is the beneficial intention and effect of the action that make it an object of feeling at all.

Our neighbours are all mankind, and if kindness is to be the principle governing our behaviour to them, it is a mightily pregnant idea. Kindness ordinarily means kindness to individuals, but when it extends to a community, and is renamed benevolence, or philanthropy or social spirit, its implications are still the same. Economic activity or work is a part and indeed a very great part of our behaviour to our neighbours. The same moral principle that enjoins kindness to individuals makes the welfare of a community the end of economic action.

A foundation which is called upon to support so great a structure makes heavy demands on our faith, faith not in any particular set of dogmas, but in something that may be read into all religions, and is not dependent on any.

Even before the parable of the Good Samaritan was spoken, the idea that every individual is neighbour to the whole world, and should not exclude the welfare of any one in it from his purview, had gained a footing. If the parable commanded assent and needed no argumentative support, that was because the promptings of kindness are felt independently of the cleavages by which mankind is divided. The duty of kindness was not a mere disciplinary rule of conduct imposed by authority; it revealed and formulated what was already felt.

On the other hand, the cleavages of mankind have existed from time immemorial, and have been associated with deep-seated loyalties which have perpetually tended to narrow the field. The cleavages which to primitive man made every stranger an enemy have survived under the international anarchy. The paramount claims of organised force exact a loyalty to the community, which refuses to admit any superior obligation.

2. Here is a sinister rival to the ideal of welfare, a rival, too, that claims to have a philosophical justification. Nineteenth-century thought was deeply influenced by the Darwinian doctrine of Natural Selection. Natural Selection explained not only the physical characteristics of each species of animal but also its instinctive propensities as being evolved through inheritance and the principle of the survival of the fittest.

Within any species the progeny of those individuals with characteristics favourable to survival would tend to multiply, while those with unfavourable would die out. And among different species those which evolved characteristics more favourable to survival would tend to displace the others. The less favourably endowed species would die out altogether, so that the characteristics of the surviving species would tend to be more and more of a kind conducing to survival.

Consciousness itself has a survival value. In animals it is the seat of instincts which guide them in feeding and breeding and in defence. In man instinctive behaviour is supplemented by rational behaviour; he devises means of attaining ends which are consciously desired. But, it is argued, in this field, as much as in those of physiology and instinct, the survival of the fittest must be at work. The people whose choice of ends and means best conduces to survival will survive, and principles of conduct or customary observances which do not pass that test will be lost in oblivion.

The next step is to maintain that the imperatives of the moral code have acquired their authority simply because they have conduced to survival. All rules of conduct which promote the co-operation of members of the community in a common purpose have a survival value. That applies not only to loyalty, courage and self-sacrifice, but to honesty, industry and intelligence. And even kindness within the limits of the community facilitates co-operation.

A purely egoistic philosophy, making the individual's own satisfaction the sole end of his actions, would find its place in this account of human nature. Congenital propensities extend the individual's satisfactions to include the satisfactions of others. Instincts of family affection seek satisfaction through the satisfactions of the other members of the family. And there are instincts of sympathy in virtue of which a man derives satisfaction from the satisfactions of others who are outside the limits of the family.

It would follow that if the good man is the virtuous man, his goodness is found to consist in conformity to rules of conduct which promote the survival of his community.

3. But it is not possible to stop at that point. Virtue is right conduct, and conduct is essentially the means to some end. If the rules of conduct prescribed by the moral code are necessary to the co-operative action of the members of the community, they are the means of attaining whatever end that co-operative action may be directed to, whether predatory force or the highest ideals.

I have described organised force as a rival to welfare in its claim to be the end. But force is essentially not an end but a means. If it is accepted as an end, that is because security depends on organised force, and all other ends depend on security. Organised force appears as the indispensable means for the community, as a community, to accomplish *anything*. Under the international anarchy peace is potential war, and negotiation, diplomacy, treaties, all the machinery of international relations are nothing but war without the fighting.

When anything is the means to a wide variety of ends, so that all the desires and aspirations directed to the ends are concentrated in the first instance on the means, human nature is only too apt to erect the means into an end. It is not possible to maintain continuously

and unremittingly the emotional state associated with a vivid representation of the ends, and the state of desire properly belonging to the ends becomes transferred to the means.

There are other examples of such a transfer besides national power. Money is one. Money is the universal means to the acquisition of wealth. If anyone desires wealth, the first step, whatever kind of wealth he may decide on, is to get money. Money therefore becomes an object of desire, even when the kind of wealth to be acquired with it is left undetermined and uncertain.

The *acquisition* of wealth itself is an example. The use of the products of which wealth consists is a means of satisfaction, but the best way to ensure the use of any product in case of need is to possess it. For many products of course use is impossible without possession. But even where use in common is practicable, the exclusive use conferred by possession is more secure. People with plenty of money to spend like to accumulate a stock of things suitable for a wide variety of contingent needs, though the occasions for using some of them may rarely or never occur.. Whether the object of acquisition be money or material products, this is the spirit that animates what Professor Tawney calls an acquisitive society.

A means thus perverted into an end may be called a False End.[1] It is usually some form of power, but not invariably so. The moral code, as we have seen, is a means, not an end. Yet the moral sense in a civilised community becomes so deeply ingrained that conformity to its rules comes to be accepted as an end. That is, up to a point, a good working assumption. But it is not without its dangers, since it may interpose an insuperable obstacle to desirable amendments in the moral code. From time to time sects and movements which erect the rules of righteousness into the end of conduct bring them into disrepute in the eyes of those who aspire to wider ideals. It was perhaps a conviction of the emptiness of moral codes, whether enjoined by religion or explained away by science, that impelled Nietzsche to that spate of confused epigrams which has passed for a philosophy among his countrymen.

If the acceptance of morality as a false end is up to a point a useful illusion, the same may be said of liberty. Liberty is the means of many desirable ends, perhaps of all the most desirable ends, but yet it is no more than a means. People are rightly willing to face fearful perils and ordeals to secure liberty, and not merely each for his own liberty but for one another's liberty. The greater the sacrifices made to secure liberty, the more imperative it is not to waste so precious a state when it is attained. If we promote one another's liberty, we ought also to promote one another's welfare.

It is the international anarchy that makes organised force a vital

[1] See *The Economic Problem*, chapter xxvi.

necessity, and constitutes it a false end. To keep the community independent and immune from oppression by rival communities appears to its adherents to be the indispensable condition of all their aspirations and activities.

Is this perhaps after all an illusion? Is the intense dread of inferiority of power or even of loss of independence an obsolete survival from a bygone age? It may be argued that a country which no longer cared to defend itself would no longer value its economic resources as a source of power, and could cheerfully give up whatever its neighbours chose to take. The extent to which they could profitably plunder it would in any case be subject to limits, for, if they deprived it of the means of continuing its economic life as a going concern, they would find that they had killed the goose that laid the golden eggs.

Even in times when conquerors were inclined to clemency, this line of argument only gave a very equivocal prospect of a tolerable economic existence. A dominant nation could use its power of despoiling an unresisting victim to reserve to its own people practically all the profit-making opportunities, the lucrative concessions and the posts of responsibility, and the population could be kept at work under conditions just so far tolerable as to keep up their productive efficiency. Such measures could be inflicted by superior power without proceeding to the length of formal conquest and annexation.

Nineteenth-century liberalism and let-do taught a milder policy, and progress towards emancipation of subject peoples, or at any rate towards fair opportunities for them, has continued in the twentieth. But across that beneficent movement has torn the rage of totalitarian frightfulness. The dominant party of the totalitarian State rejects all standards but its own ascendancy. It is so constituted that it can at a stroke absorb any community which is too weak to resist it. It rules them by repression and oppression, which are not only the means but the outward evidence or symbol of ascendancy, and even the restraints of enlightened plunder are not allowed to stand in their way.

In face of such a menace the claims of independence and security on the members of the community are rightly regarded as imperative. The sentiment which impels them not merely to rally together to resist actual attack, but to make every effort to accumulate and organise the resources needed to support resistance, cannot be argued away.

Here is the economic motive that is set in opposition to the pursuit of welfare, and is only too prone to overshadow it. The very magnitude of the sacrifices, personal and economic, which people are called upon to make in the name of patriotism and security comes to be taken as a measure of the supreme importance of the end aimed at.

When we stigmatise any prevailing motive as a false end, that does not mean that its importance as a means is to be neglected or underestimated. Mankind ought to go on conforming to the moral code,

devoting themselves to liberty, and facing exertions, privations and risks for the sake of national security. And it is legitimate to seek money and wealth in so far as the economic system calls for a certain degree of self-seeking for its effective working.

But these all have their limits, which cannot be discerned unless they are recognised to be no more than means. That applies, as we have seen, to the moral code and to liberty. Still more does it apply to money and wealth, the pursuit of which easily becomes a selfishness conflicting with natural human sympathy and with the moral rule of kindness. But in none of these false ends is the harm that may be done so far-reaching, so devastating as in national power.

It may be contended that some of the activities associated with these false ends really are good in themselves, and are true ends. The good attributable to virtue is not confined to the results of virtuous behaviour in the well-being of the community; the satisfactions that virtuous people derive from promoting the welfare of their neighbours may be counted among the higher forms of happiness. The enjoyment of liberty may be a desirable emotional state, even apart from the uses to which the liberty is put. Even pride of possession is in moderation a legitimate gratification.

And of course a man's devotion to his country, and the courage, endurance and self-sacrifice with which he sustains it, may well command admiration. The frightful evils of war bring out qualities of which mankind is rightly proud. The capacity for leadership ranks high among them. It is that which entitles a man to be called by history 'great.' And pre-eminent among great leaders are great leaders in war.

But after all it is because war is so immense an evil that the responsibility of a leader in war is so heavy, and that the qualities in the mass of people that make for prowess in war are so highly esteemed. There is infinite scope for leadership in the affairs of life, without bringing in war. Leadership is needed wherever there is purposeful co-operation, and is more fruitful, if less spectacular, when the common purpose is some positive good.

It is of the essence of these false ends that they are of special importance as means. And some of them are means of welfare in a very positive sense. Liberty is the soil in which welfare grows, morality is the fence which protects the field, economic self-seeking is like a manure which, though evil-smelling, does fertilise the growth when applied in judicious quantities.

But the cult of national power makes no positive contribution to welfare. Even when no actual conflict occurs, whatever some countries gain through the influence of superior power others lose. When a challenge is accepted and war results, each combatant inflicts injury, suffering and destruction on the other, and it is still true that whatever

compensating gains the successful one makes are at the unsuccessful one's cost and aggravate his misfortunes.

If national power has the far-reaching importance as a means which must be characteristic of anything that is elevated into a false end, that is due not to any good that is hoped for from it, but to the magnitude of the evil against which it claims to give security.

Power in the sense of power to coerce is an essentially sterile end. In the competition for power there are no prizes, only penalties.

The claim often made by a conqueror, that he is conferring a superior civilisation upon the conquered, is not always without foundation. There are primitive races which have never succeeded in evolving the necessary centre of organised force to support law and order. To such the organised force at the disposal of a conqueror may be a real benefit. Conquest by overwhelmingly superior force is relatively easy, and it ought not to cause more suffering or destruction than the suppression of disorder must in any case involve. And, conquest once completed, there may be less violence and use of force than before. But the benefit received from a conqueror may be dearly bought if his real purpose is exploitation in his own interest. A conqueror cannot tenably defend his action on the ground of the benefit to the conquered unless he is prepared to engage in a genuinely disinterested pursuit of their welfare.

But it is not an aspiration after beneficent conquests that has raised up organised force to be a false end. The fanatics of national power, when confronted with the fact that power is after all a means and not an end, may have recourse to a claim that their nation is that which in comparison with all others represents the highest type of civilisation. But that is an afterthought, and the inference they insist on is not that the exponents of this civilisation should spread its merits peaceably among their neighbours, but that it entitles them to take what they can get at their neighbours' expense.

One who has the nature of a rebel may be tempted to set out with a denial of all accepted standards of good and evil. But when the destructive phase is done with, and something positive has to be put forward, it is not so easy to sustain the denial consistently. Nietzsche delighted in demolishing his contemporaries' standards of morality, religion, philosophy, science and art, and in reiterating his thesis that nothing should count in comparison with power—mere power, divested even of any end or purpose. The will to power was to distinguish Nietzsche's superman from the herd. The herd were to conform to the rules of morality in order that they might serve the superman. But when he comes to describe the character of the superman, Nietzsche can only appeal after all to mankind's common sense of values. The superman is to be emancipated from the moral code which the herd must still obey, but that is only because Nietzsche contends that a

different code, permitting lying, cruelty and vice, will produce the best results. He thinks the superman good, and hopes to persuade other people to think the same.

It might be that mankind is so constituted that the greatest good can only be found in a small number of saints or supermen, and that the contribution from the lives of all the rest is negligible. One who claims to be capable of ineffable experiences, compared with which all else is insignificant, can be accommodated with a cloister or a hermitage without being required to submit his claims to criticism. If, however, the claim is not for opportunities of mystical contemplation but for the subordination of other people's activities to one man's command, the validity of the claim depends on the purposes for which he would use his power. If, as in the case of Nietzsche's superman, those purposes concerned only himself, and the rest of the community were to be allowed no share, the claim could only seem valid to a distorted mind.

It is not possible to discourse intelligibly about human affairs without postulating standards of good and evil. If it be desired to show that any particular standards are wrong, the only way is to argue, as Nietzsche did, that some other standards are better.

CHAPTER XIII

ECONOMIC WELFARE

1. Let false ends be rejected and let welfare in its deepest and broadest sense be the end of economic activity. How is that to be translated into practice?

Economic welfare is that part of welfare which is contributed by work. To begin with, it will be useful to make a distinction between two kinds of products. On the one hand there are those which maintain life and health, and guard against injury, pain, discomfort and fatigue; on the other there are those which confer some positive benefit or enjoyment. The former may be called 'utility products,'[1] the latter 'creative products.' Not that there is any clear dividing line between the two; indeed both characteristics are often united in a single product. To the extent that clothes, furniture, houses and the appliances and utensils of everyday life are ornamental or are so designed as to be decorative or attractive, they take on something of the characteristics of creative products. Food and drink are primarily utility products, but, in so far as they give the pleasures of the epicure, are creative.

Utility products are by no means confined to the things which provide a bare maintenance. They include many of the appurtenances of a life of luxury, not only those which avert discomfort (averting, it may be, slight discomfort at relatively high cost) but those which save labour and increase leisure. Civilisation has extended the scope of utility products so that people with moderate incomes are reasonably well equipped with them. Only in conditions of poverty are they seriously deficient. And even people counted poor enjoy some facilities (in sanitation, for instance, or hospital treatment) that would have been unknown to rich men in past centuries.

It is especially in utility products that inequality of resources offends our sense of justice. That some people should suffer privation and distress because the resources that might relieve them are absorbed in supplying others with superfluities is an outstanding blemish in the organisation of society. It results from competitivism relying on demand to regulate supply, when the demand emanating from hard-earned wages has to compete with that emanating from the easy gains

[1] In *The Economic Problem* (chapter xvii, p. 189) I used the expression 'defensive products,' but the term 'defensive' is unsatisfactory, as it suggests a connexion with defence. 'Utility' might be criticised on the ground that economic usage applies it to all sources of value, including the creative. But the phrase 'utility products' obviously presupposes a narrower sense in which utility does not attach to all products. And I think the sense in which I propose to use it does conform closely to common parlance.

of profit-making and accumulation. It is the aim of the social services to mitigate this inequality.

Utility products, being required to meet ascertainable needs, can to a great extent be planned by one person for another. People of course have idiosyncrasies which afford some scope for individual choice even in the satisfaction of these needs, and the most complete satisfaction could not be obtained by imposing diets, or patterns or standards of housing, clothing, utensils or furniture without regard to these idiosyncrasies, even from the utility standpoint. But for the most part the planning and production of these things are technical matters, and (apart from the intrusion of the creative aspect) there is little scope for the exercise of the consumer's preferences.

Utility products supply no *positive* good. They play a great and vital part in the total of welfare, because the distress and harm resulting from a deficiency of them may be a heavy debit against whatever welfare the community may otherwise enjoy. But the reduction of this debit even to zero only clears the ground for a good life of a positive kind.

It is the function of creative products to contribute something positive to a good life. But it must not be supposed that even they are necessarily the principal constituents of a good life. By products we mean marketable things. They are the products of work, that is, of organised effort. Organised effort means not only the operations of the trader carrying on a productive industry with hired labour, but also the work of an individual who carries on his vocation single-handed, and independently of any employer, for he depends for his own support on the marketing of his product or on whatever provision the economic system of the community makes for him. The division of labour itself amounts to organised effort.

Some creative products are embodied in utility products. As we have seen, things primarily intended to be useful may be made decorative or otherwise attractive, and a part of their value is to be imputed to this characteristic. Even if it does not add appreciably to the cost of production, it may add to their market value. If it does neither, it can hardly be assigned the status of a 'product'; it becomes rather one of the amenities of life arising outside the economic sphere, as when people sing or chatter at their work.

But there is a wide range of products which participate in both characters, and the contribution of which to welfare has to be divided between the utility character and the creative character in significant proportions. In some the creative side predominates, and some products are exclusively creative, such as works of art, entertainments, literature, and the appliances for sport and games.

A special characteristic of a creative product is that it is not devised like a utility product to meet a need previously felt; the need only exists

because the product exists. Many creative products are mere repetitions or adaptations of what has been done in the past, and become a matter of routine. But in general any creative product, being a thing which sets out to please, is likely to have called for some act of creative imagination in its origin. A utility product, it is true, will likewise have been originated by an inventive idea, but that will have been devised for meeting a *given* need, and there may be scope for the same kind of invention also in the manner of producing the creative product. But for the creative product that comes at a second stage, after the nature of the product itself has been conceived.

Thus among the factors producing the creative product there is to be found this one of creative imagination, in addition to the ordinary constituents of cost, the remuneration of labour, the interest and depreciation of capital, and profit.

For the purposes of economic analysis the exercise of creative imagination need not be distinguished from any other services rendered. Like many other services, it may be rendered by the trader himself, so that its remuneration (if any) is merged in his profit, or alternatively it may be rendered by someone employed at a fee or salary. The market will offer as a source of this remuneration the extra demand or extra price which the product will command in virtue of its more attractive quality. It is the function of the traders, that is to say, of producers and dealers between them, to decide what things shall be produced and offered for sale to the consumers, and profit-making depends on success in inducing the consumers to buy. Along with the not very admirable arts of pushing sales and inveigling the consumers, the traders may make a more commendable appeal to the consumers' real needs and tastes.

For utility products the consumers themselves feel the need, and, when invention or applied science shows the way to meeting the need, it is for the traders to follow. But in the case of creative products it is the trader who leads. An individual consumer may exceptionally take upon himself the creative responsibility and instruct a producer to work to a specification. But where the consumer takes no initiative, and is content to choose from the products offered him, this responsibility devolves either upon dealers who order goods by specification from producers, or on producers themselves.

2. Where creative products are manufactured by an organised division of labour, the producers are profit-making traders, and their decisions as to the nature of the product are included in the services remunerated by profit. Competitivism assumes that the exercise of the trader's creative faculty will be guided by the prospect of selling the product; it becomes a constituent of selling power.

But creative products are far from being all of a kind capable of being manufactured in the mass. There are services and works of art

essentially individual in character, produced by individual artists, who, even if they incur expenses (for example, on studio accommodation, materials, instruments, and in some cases on labour), have not the ordinary characteristics of traders. Their fees or the proceeds of sale of their products are essentially personal remuneration, and whatever has to be deducted in respect of costs is no more than a minor set-off.

The position of the individual artist is a weak point in the competitivist system. The creative imagination is not easily accommodated to commercial motives. A trader supplying creative products for sale may treat his business merely as a source of profit. His products may perhaps be such as embody no new or original ideas or patterns, but meet an ascertained demand from consumers who are already familiar with them. Creative products are not confined to objects of artistic merit or originality. They include any means of entertainment, recreation or indulgence, and may have no other virtue than that they give a passing pleasure or relieve monotony. Nor does an individual producer necessarily work for any higher motive in taking advantage of the demand for such things. There is nothing blameworthy about that. Indeed, if boredom is painful, a thing intended to relieve it may be regarded as a utility product, and the trader who makes money by supplying it is following the same path as one who supplies any other sort of utility product.

But in any community the opportunities open to the creative imagination are of very special importance. Its economic application to marketable products is only a part of the field. The creative imagination extends over every branch of culture, art, science, learning and literature, the beautiful, the interesting, the humorous. There is scope for it in conversation, conviviality, entertainment, sport. Indeed whatever in human intercourse rises above the satisfaction of existing propensities and desires calls for initiative on the part of someone.

Over the greater part of the field this initiative is given spontaneously, outside the sphere of economic relations and paid work; one who possesses the faculty exercises it not in the work by which he earns his living but with his family and friends. But a special value attaches to those creative activities which are not of this light and ready kind, and which demand the devotion of a lifetime.

It is there that the professional artist finds his vocation. But it is unlikely that he is placed in it by the operation of simple competitivism. His impulse to create is not dependent on the economic motive. He is indeed compelled to obtain the means of living, and, if he has no other resource, must gain it by selling his products. But the market for his products depends on their being appreciated by possible purchasers. There is a danger of a tragic failure of the remuneration of the artist to correspond with his real merits or even to support his

primitive needs. The real merit of artistic or intellectual work often resides especially in its originality, and its very novelty may result in a failure to gain the appreciation of contemporaries.

Artists, writers, and men of learning or science are sometimes compelled to earn their living by teaching or by producing work superficially attractive to the many as pot-boilers, pursuing their really serious work for little or no remuneration. Or they may be supported by rich patrons, or by endowments or by State-aided institutions. Any position other than the possession of independent means is only too likely to restrict their freedom. And, if a limited number are to enjoy the privilege of being supported, the selection of the favoured individuals is an invidious process, from which the prejudices of patrons, or boards of trustees or governors are not easily excluded.

Artistic or intellectual achievement is the privilege of a few. He who makes it a career and a whole-time occupation must have exceptional qualifications. And the achievement, when realised, is not the exclusive possession of his own community, but may become available to the world.

On the other hand, *appreciation* of these things is a constituent of the welfare of the many. Human intercourse needs to be enlivened by some objective interest. When the work necessary for supplying the needs of the community is reduced by technological progress, the gain is in leisure. Leisure is not itself welfare; it is only the opportunity for welfare. Leisure may be pleasurably spent in recreations, sports or games that exercise the natural instinct for activity (an instinct which has a high survival value, and which man shares with the animals). Or it may be given to entertainments which pass the time with amusement, gaiety or excitement. These pleasures are not to be excluded from the conception of welfare, especially when the sharing of them gives people opportunities of companionship. But if entirely destitute of artistic inspiration or intellectual interest, they are in themselves trivialities.

'Artistic' here is to be taken in a wide sense, as comprising not merely beauty of form, colour or sound, but all the varied effects which those skilled in the means of expression obtain by playing upon the human capacity for emotion. Besides sensuous beauty, art so understood includes all the varied appeals of literature and drama, whatever is interesting, humorous, stirring. Welfare is infinite, and cannot be comprised within a formula or defined by a specification. But it may, I think, be so far defined as to be limited to states of consciousness, and not merely states of consciousness but of feeling. Mere sensation or mere thought, destitute of any emotional reaction, is not included in it. Intellectual activities may have great value as *means* of increasing welfare, but are only to be counted as an end in so far as they are interesting. Being 'interested' is a state of feeling; it is the intellec-

tual satisfaction accompanying a successful pursuit of truth and understanding.

If competitivism has to confess a deficiency in the provision it makes for creative products, that is partly consequent upon the shortcomings of the consumers by whose demand the supply is governed. But even if the consumers had unexceptionable taste and discrimination, there would be no certainty that every worthy artist or writer could sell his works in quantities and at prices that would provide adequately for his living. The true merit of original work cannot be measured by the amount of money contemporaries are willing to pay for it. They may admire it and yet not desire to possess it, or those who desire to possess it may not have the money to pay for it, or it may fail through want of publicity and selling power to come to the knowledge of those able and willing to pay for it. Where the original work is not in art but in science or learning, the product cannot be put on sale except in the form of teaching or publication of results. (The case where a scientific discovery is embodied in an invention that can be patented and yields money from royalties does not often arise for the theoretical scientist.)

If provision is to be made for original work outside the free operation of competitivism, the responsibility will devolve on public authorities, and its discharge will depend upon their taste and discrimination. If the public generally were well qualified in these respects, presumably their Government would be equally so. But it is only too likely that the discrimination of the public will be very imperfect, and that of the Government no better. No way has yet been discovered of ensuring enlightened standards of taste in Governments and public officials. It is not merely that it is difficult to select individuals with the desired power of discernment, but an official department or organisation does not easily work so as to give sufficient freedom to the individuals concerned in its decisions. The only satisfactory solution hitherto found of the problem of providing for original artistic and intellectual work is to allow the maximum of freedom to those who have the desire to undertake it, to let those who have the aptitude make a pecuniary success of it in a free market, to make some provision for a limited number of selected individuals in endowed or governmental institutions, and to trust to luck for others who have the power of accomplishing something to find some subsidiary means of support which will not crowd out their better work.

Competitivism is ostensibly based on freedom, and this is a sphere where freedom is especially valuable. Even though the freedom is in practice terribly circumscribed by the obligation to earn a living within the opportunities offered by the labour market, competitivism does give a free field within those limits. And it gives a free field to the consumers' preferences. That, as we have seen, has its disadvantages,

in that the mass of people, even of people with means, cannot be expected to exercise a reliable and discerning appreciation of new and original work. But popular taste is not so defective when it is called on to appreciate not the works of original genius but beauty of design applied to the common marketable products. Any utility product is formed after a design which depends primarily on its purpose, but which still has some freedom of variation, and can be made within limits beautiful or ugly. The limit may be very narrow, or the product may be insignificant, but many utility products, such as buildings, furniture, and to some extent clothes, are capable of artistic merit of a high order—so much so that in some instances the aspect as creative product greatly predominates. The prevalence of beauty of design in the common things of everyday life is a big contribution to welfare.

It may be that, in some parts of the world at any rate, the beauties of nature are a much bigger contribution. But one of the aims of creative products should be to avoid spoiling the beauties of nature. That applies especially to buildings and conspicuous structures or clearances, which may be terrible eyesores, and which, if they cannot be made positively pleasing, should be made to blend as inconspicuously as possible with their surroundings. The freedom of selection by consumers is a valuable feature of competitivism, but it does involve allowing the individual to erect structures which, while serving his own purposes, may be of a design to outrage the taste of his neighbours. When the beauties of nature are violated, what suffers is a response of human feeling, which is more fundamental than artistic taste.

3. The contribution of economic activity to welfare is not to be estimated in terms of wealth, or measured by money cost or market value. On the one hand things of high price may contribute little or even less than nothing to welfare. On the other organised effort or work may be directed to ends far transcending the cost as measured by the remuneration paid for the work.

Remuneration sufficient for maintenance may be an indispensable condition of enabling people to do work, but qualitatively it is no measure of such work as art or scientific research. Religious bodies are an illustration. When they need the whole-time service of priests, pastors, missionaries or others, they must provide from some source, such as endowment, subscriptions or fees, for the support of those they employ. But there is no relation between the value of the services rendered and the payment made for the maintenance of those who render them.

Education is another example. The value of a good education as a contribution to welfare is measurable only in terms of the life lived by those who receive it. Even when parents pay a high price for it, that may be a measure rather of the resources at their disposal than of the merits of the education paid for. A good education may be

appreciated by an enlightened few with slender resources, and may fail to command more than a quite low price. The merit of a State-provided education depends on the competence of the teachers and the efficiency and enlightenment of the administration. In a community where the necessary talents and aptitudes are common, and appropriate training readily available, the cost of providing a good education for all need be no more than that of paying normal middle-class salaries to the necessary numbers of teachers and administrative staff, together with the expenditure on accommodation and equipment. The cost will no doubt be greater than if the education is scamped, but may not exceed the cost of an equally lavish but misdirected system.

From one point of view this is merely an example of the familiar principle that market value depends on scarcity. But that is not the whole story. Scarcity value depends on what consumers are able and willing to pay. When plenty takes the place of scarcity and price falls, economic theory regards the consumer as obtaining a windfall or 'consumer's surplus,' measured by the difference between the actual price and the higher price he would have been willing to pay rather than go without the thing. The calculation is extremely hypothetical, and in any case it only purports to measure the consumer's valuation of the thing relative to his other needs, and subject to the limit of his total resources. The consumer's surplus so conditioned may have no more relation than the actual price to the excellences with which wisdom and enlightenment may inspire services such as education.

The inappropriateness of money value as a measure of welfare is not confined to creative products. There are utility products of which the contribution to welfare, even though preventive and not positive, immeasurably exceeds their cost. The consumer's surplus in respect of the essentials of subsistence is sometimes represented as 'infinite,' in that there is no economic sacrifice which a man would not make rather than perish of starvation or exposure. But the sacrifice that he *can* make is strictly finite; it is limited to the resources he can dispose of. The surplus is more properly reckoned in terms of the resources of the community than of those of the individual. The essentials ought to be treated as a first charge upon the community's productive capacity. Taxation is imposed in order to enforce that first charge. Poor relief supplements the working of markets, when that fails to meet the elemental needs of the individual. Governmental organisations provide for law and order and numerous needs which for one reason or another are not adequately met in response to free demand. And they provide for defence.

War finance shows up in high relief the inadequacy of money as a measure of worth. A people at war will expose themselves to losses and injuries obviously beyond any such computation, and yet the cost is reckoned in terms of the payments made for services rendered and

by way of compensation. The incommensurability has become a commonplace.

Work is a means. It needs the immediate motive of gain or compulsion or customary obligation, because the ends to which it is directed are co-operative and are too remote from the interests of the individual to secure reliable and systematic service. Nevertheless work is often an end. Skilled work is a source of pride to one who sees himself contributing efficiently to a desirable product. Even very humble work helps to satisfy the instinct for activity. What makes unemployment intolerable is not only the loss of earnings, but the cessation of what is usually the principal activity of life. This aspect of work is an important part of economic welfare.

4. We have taken welfare to be the end of human action in general and economic action in particular, and have contrasted welfare as the end with codes of moral rules as being merely means. But if the moral code is understood to include the principle of justice, have we not pressed the contrast too far? The principle of justice does indeed guide conduct, but is that not because justice itself is an end?

It is in the name of justice that economic equality is claimed. But the claim has several distinct aspects. Democracy rebelled in the first instance against the privileges which had survived from feudalism, privileges attaching to hereditary land-ownership or to chartered corporations. There must inevitably be a tendency for any vocation to become hereditary. Even apart from the inheritance of congenital aptitudes, there is no better source of vocational instruction and advice than a parent. This applies to the more eminent and responsible positions as well as to the humbler, and leads to the evolution of classes or castes reserving to themselves the most eligible appointments and professions. Outsiders who are qualified by character and ability for them, but are excluded on grounds of birth, rightly feel themselves to be treated unjustly, especially if the hereditary privilege is maintained by law.

The equalitarianism of eighteenth- and nineteenth-century democracy swept away most of the legally upheld privileges, and there emerged the principle of distribution embodied in competitivism. Economic justice according to competitivism entitled everyone to receive in wealth the equivalent of what he contributed towards production, the equivalent being measured by exchange value. It was a system of rewards and punishments; he who contributed much received much; he who contributed less than the equivalent of his necessary subsistence could not subsist.

Humanity could not accept the rigours of justice so conceived, and even before the social services came to be developed there was a system of poor relief to provide subsistence. But even so, when the free working of markets gave opportunities for profit-making on a large

scale, there seemed to be a flagrant departure from a just distribution. The big rewards were earned too easily and put too much power over the productive resources of the community in the hands of a few fortunate individuals.

Against the system of economic rewards and punishments was propounded a rival conception of justice. Production was the fruit of work. Under a division of labour everyone contributed to the result, and, apart from shirking, all ought to share equally in the output.

Here were two conflicting interpretations of economic justice, and so long as they were treated as abstract principles there was no way of deciding between them. Controversy was driven to find grounds outside the sphere of abstract principles.

Competitivism upheld distribution based on the individual's production as providing the essential *incentive* to economic activity. On the other hand, in favour of an equal division of wealth it was argued that if one man has a bigger share than another he can go further in satisfying his needs, and if some of his wealth is transferred to another it will be used to satisfy more urgent needs, and will so produce more welfare.

Obviously that was not universally true, for one man has greater needs than another. So the formula, distribution according to needs, was arrived at. If needs were measurable, that would attain maximum welfare, provided the weakening of the economic incentive did not cause a counteracting loss.

But to recommend a method of distribution on the ground that it increases welfare is to treat distribution not as an end but as a means. That means that justice of distribution is not regarded as itself a *component* of welfare.

The issue cannot be altogether put on one side as a matter of academic hair-splitting. The sentiment in favour of just distribution is powerful and deep-rooted, and much may depend on the manner in which it is interpreted and applied. It is in fact one aspect of the human disposition towards kindness.* As soon as the sentiment of kindness is directed beyond the field of personal contact to a community or to all mankind, discrimination against individuals or sections is felt to infringe it. But that is so only so long as there is not a sufficient reason for the discrimination. And a sufficient reason is not necessarily confined to a measurable need, such as the support of a family. A man may be recognised to need creative products just because he knows how to use them or to enjoy them ; he may play polo or collect old china.

Or the competitivist principle of payment for services rendered may be held to be sufficient reason. If profit-making is attacked as an abuse and an injustice, that is because the trader is believed to

extract from the market a bigger reward than the services he rendered merit.

Economic justice is an ' end ' in that the satisfaction of the desire for it is itself good, and injustice is an evil alike to those who inflict it, to those who suffer from it and to those who gain by it. But what is or is not justice depends on the views of the people concerned.

Perhaps the interpretation of justice that would command the widest assent at the present time is equality of opportunity. Everyone should have free access to the career he is best fitted for, and if his parents have not the resources to prepare him for it there should be public provision for doing so.

CHAPTER XIV

FUTURE PEACE

1. MUCH in the economic destiny of mankind depends on matters lying beyond the limits of economics. Among these one problem which transcends all others is, how to rid the world of war. So long as every nation is exposed to the risk of a conflict in which its security is endangered by the organised force of another, the maintenance of organised force will take precedence of all other economic ends. If peace is always to be potential war, and every generation in turn is to see potential culminate in actual war, then whatever of productive capacity is left over from repairing the ravages of one war will be used up in preparing for another.

Technological development has so enormously increased both the power of concentrating productive resources upon organised force and the destructiveness of war that these problems have become more urgent than ever before in the history of the world. The recognition of that terrible fact led to the experiment which took shape in the League of Nations.

A noble and a hopeful experiment! Its failure must not be taken to imply that it was altogether misconceived. The League had valuable features, and some kind of League of Nations will be an indispensable part of a successful solution.

Disarmament might be carried through by international agreement without any League, but disarmament alone would not solve the problem. If a conflict of interests between two nations arose, they would not be deterred from going to war merely because both had limited their armaments. They would proceed to fight with what armaments they had maintained, and to rearm as quickly as possible. The conflict would probably be prolonged by the time necessary for the combatants to develop their full strength, and might very likely be all the more sanguinary and destructive.

An agreed limitation of armaments would without doubt have great advantages. So long as it was effective between wars, it would relieve the productive power of the world from a part of the strain of armaments, and it would prevent the occurrence of that dangerous situation in which a nation, fearing that it is about to be overtaken in the competition of armaments, precipitates a war while it can still hope to hold its own.

But any country which finds that its potential resources have so grown that its allotted armaments are not in due proportion will ask for a revised allotment, and every such demand will be a dangerous cause of friction. And the outbreak of a major war anywhere is bound

to bring any agreement for the limitation of armaments to an end. The combatants can no longer conform to it, and the others cannot let the combatants outstrip them.

A radical solution of the problem of war is to be sought in another direction. Some other way must be found of settling those conflicts of interests which lead to war.

The League of Nations provided well-planned machinery of arbitration and conciliation. But that by itself is not enough. Arbitration and conciliation inevitably take as their starting point *existing rights*, and there may be an irreconcilable conflict between the rights of one country and the needs of another. When the needs are supported by a greater force than the rights, a settlement in favour of the rights will be precarious. Arbitration will settle wholly in favour of the rights; conciliation will seek for a compromise, which will obtain a partial modification of the rights so as to meet the most pressing of the needs, but probably only at the price of some balancing compensation.

So long as conciliation is no more than a peaceful substitute for war, it must take account of the *relative power* of the parties to the dispute. If no settlement is reached, the more powerful will prevail, and if the comparative strength of the parties is evident, the more powerful cannot be expected to accept a compromise much less favourable than a contest would have yielded. Thus any departure from the legalistic recognition of existing rights tends to be in the direction of a recognition of superior power. If it is not, if any concession is demanded of the more powerful disputant beyond what he is willing to give, the settlement is likely to be precarious. And once any country rejects or repudiates a settlement arrived at by an international organisation such as the League, the whole system is endangered.

The League was equipped with ill-defined police powers. Economic sanctions proved to be inadequate even against Italy, a country especially vulnerable to them. A resort to military force was intensely repugnant to supporters of the League. Nevertheless a system of collective security, which would have amounted to a military alliance of all the members of the League against aggression, was advocated by many of them. They hoped that the alliance would wield such overwhelming force that it could overawe any recalcitrant State, and that an actual conflict would never be necessary. But when the recalcitrants included Germany, Japan and Italy, and the League did not include the United States, there was no prospect of exercising overwhelming force. Indeed, so long as the rearmament of France and Great Britain lagged far behind that of Germany, the preponderance was only too plainly on the side of the recalcitrants.

It may be that in the future something in the nature of an international force which no recalcitrants can hope to resist will be evolved. In the years following the war of 1914–18 the armed forces of the

victorious Powers held a position approximating to that. But they were never willing to use the threat of force except in their own interests, and even in 1922 they failed to overawe Turkey and prevent the revision of the Turkish Treaty of Peace.

In any case an international force cannot be used to coerce recalcitrant States unless it receives such thorough and loyal support from the international organisation it represents that the appearance of recalcitrants will only be occasional and exceptional. And that condition will not be fulfilled unless the settlements to be enforced are such as to command the general approval of the world.

2. It will not be enough to give full effect to all existing rights and agreements. Every civilised country recognises that the rights and contracts of *individuals* must sometimes be overridden or modified in the public interest. One of the functions of a legislature is to determine for what purposes and on what conditions that should be done. Many enterprises, particularly those of public utilities, are only made possible by private legislation, that is to say, by acts of the legislature expropriating land-owners and abrogating private rights. A legislature called upon thus to override existing rights evolves principles defining what is equitable and reasonable. The privileges granted to the promoters are limited to such as are really necessary in the public interest for their enterprise, and those whose rights are infringed are awarded suitable compensation.

An international tribunal administering a procedure analogous to that of private legislation might be the means of resolving many international conflicts of interest. The absence of any adequate means of getting pre-existing rights and treaties modified or abrogated was an outstanding defect in the constitution of the League of Nations. Article 19 of the Covenant, which merely authorised the Assembly to advise the reconsideration of treaties which had ' become inapplicable,' was never in fact resorted to.

The rights of a sovereign State are territorial. It claims jurisdiction over its own nationals even when they are outside its territory; but in the last resort its power over them is limited to what it can do within its own borders, whether through property or interests which they retain at home, or through themselves returning home. For the most part the discipline it applies and the protection it affords are for those who are within its territorial limits.

If the rights of the State are territorial, then in conflicts between the rights of two States the issue will always have a territorial aspect. A territorial right has some of the attributes of a right of property, and it is here that the analogy with the issues which are settled by private legislation arises.

Primarily the analogy applies in cases where this right is to be used for an economic purpose. Such cases we examined in Chapter IX.

Sometimes freedom of transit between a country and sources of supply or markets is interrupted by a frontier, at which not only may duties be exacted, but restraints and restrictions may be imposed. It may be not merely that freedom of transit is interfered with, but the whole transport system in a neighbouring country, roads, railways, waterways, ports, vehicles, may be designed for its exclusive convenience and in disregard of the needs of foreign users.

Enterprises in one country may be hampered not only by restrictive measures in another but by backwardness in developing productive resources. There may be materials needed by manufacturers in the former, which could be supplied from the latter, but remain unworked. Or there may be resources which the country possessing them has insufficient enterprise or insufficient capital to exploit, while there may be aspirants in the other ready to supply these deficiencies. In such instances those who find their economic opportunities impeded will have a grievance against the alien sovereignty which forms the obstacle, and, when the effects are very far-reaching, the grievance is reflected in the public policy of their own State. Examples were given in Chapter IX.

There are numerous instances of possible conflicts of economic interests being avoided by international agreements. The impartial administration of the Suez Canal and the Panama Canal is especially noteworthy. The neutralisation of the Suez Canal in time of war, it is true, has turned out to be a fiction. However neutral the Canal itself may be, access to it is controlled by the Power which has command of the sea. But in time of war economic interests become identified with strategic, and cease to be merely economic.

Navigable rivers, such as the Danube or the Rhine, traversing or touching the territory of several different countries have also been made the subject of international agreements. And railway and postal services are, where necessary, internationally regulated in detail.

So long as these agreements confer benefits on both parties with no material detriment to either, they work as easily and smoothly as the institutions of a single State within its own territory. Some of them, such as those relating to the inter-oceanic canals or the great navigable rivers, regulate major economic interests of the participating countries. And if definitive and reliable agreements could be established governing such matters as the access of Poland to the Baltic or of Bulgaria to the Aegean, one important class of international disputes could be eliminated. An essential condition would be the accession to the agreement of disinterested countries. If it were confined to those immediately concerned, war between them might terminate it, whereas, with neutrals parties to it, the agreement would remain operative, and would still bind the combatants at the end of the war.

3. There is a wider field for such agreements in regard to colonies

which are still incompletely developed than in regard to long-established and highly organised countries such as compose the European Continent. As we saw in Chapter IX, economic activity in new or undeveloped countries is especially dependent on concessions of a territorial character. And the sovereignty of a colony in that condition depends very directly on the organised force of the governing Power. Colonial rivalries have not been the most prominent of the recent causes of war; both in 1914 and in 1939 they were rather overshadowed by acute questions of territory and nationality in Europe itself. For all that they have played a great part. Germany's aspirations to a 'place in the sun' and her resulting naval rivalry with Great Britain were among the principal causes of the deadly cleavage between the two groups of Powers in the years leading up to the outbreak of war in 1914. And in 1939, though Germany's immediate ambitions were in Europe, it was inconceivable that European ascendancy would not in due course mean control of the oversea dependencies of the Western European countries.

The economic advantages of colonies are commonly identified with the supplies of materials, particularly of minerals and tropical products. But that is too narrow a view. Not that the control of these things is a secondary matter. Not only is it relevant to many wartime needs, but in peace time restriction schemes imposed in the interests of producers may conflict with the interests of users, and exchange control may interfere with supplies to countries of weak exchange position. The due regulation of the supply of natural products from colonial dependencies and indeed from independent countries of the new or incompletely developed type, is in any case a matter which deserves a measure of international co-operation to preserve a reasonable balance between consumers' and producers' interests.

But the sovereignty over colonies also covers the interests referred to in Chapter IX. It confers preferential treatment on adherents of the ruling State in the concessions on which exploitation depends, in rights of land-owning and transit and in all transactions to which the State is a party or over which it exercises any active control. Moreover colonial government offers careers to people of the professional and administrative classes.

Colonies are therefore much coveted for the sake of the exclusive privileges which sovereignty confers. It is just this exclusiveness that makes the international anarchy dangerous. The position of a colonial Power, employing organised force to govern an alien community, is an anomaly which is only tolerable in a civilised world so long as the government is disinterested. If some Powers through a preponderance of force, especially the force of sea power, and through commercial enterprise, have in the course of history secured for themselves all the eligible colonial dependencies, that is a source of grievance to those

which through accidental circumstances or through past weakness have been left out. The increased functions of sovereignty in the economic sphere and the increased importance of supplies of natural products for a total war have accentuated the advantages of the former.

If the problem could be regarded in purely economic terms, an international colonial system would be a solution. It would call for a self-denying ordinance from the existing colonial Powers. They would have to accept the position of mandatories in respect of their existing colonies, and that position would impose on them not merely the absence of any legal or administrative discrimination in favour of their own people, but a genuinely disinterested government, disinterested towards the inhabitants in avoiding any undue encroachment on their possessions or mode of life, and disinterested towards other countries in affording impartially to all facilities for whatever trade and enterprise the territory may be capable of.

As to the interests of the inhabitants much has been learned from the European administration of tropical countries in the past half-century. It should be quite practicable to apply well-recognised standards in judging the methods of government. A rule that preserves what is good and what is capable of beneficial evolution in primitive native communities is not necessarily contrary to the interests or purposes of the governing Power. Where native law or custom interposes relatively trivial rights or illusory privileges in the way of valuable economic concessions, some overriding settlement is justifiable, just as much as between two independent civilised Powers whose frontier cuts across economic development.

The general principle would be to dissociate economic facilities and concessions in any territory from political sovereignty, and to throw them open to competitors regardless of nationality or domicile. Something approximating to international government would be established in the economic sphere, and the exclusive advantages derived from the exercise of sovereignty would be greatly diminished.

There must be an international body, whether a reconstituted League or another, to which the mandatories would be responsible. And this international body would have to exercise an overriding power to revise existing rights which are judged to be obstructive to desirable lines of development. Compensation should be governed by the loss or detriment caused, not by the advantages gained by the other party. That is important, for extortionate compensation might be a grievous impediment to progress and to goodwill. Undoubtedly a settlement on these lines would often be a delicate matter. It is not to be taken for granted that every kind of exploitation is desirable, merely because it is profitable. It may be that a country rich in minerals enjoys more true welfare if they are left unworked, so that it can carry on a simple but adequately supplied existence free from the

intrusion of foreign enterprise. Whether, if the inhabitants so desire, that alternative ought to prevail, should depend partly on the magnitude of the contribution that the minerals might make to the welfare of the world, partly on the merits of the social conditions that the inhabitants want to preserve. It may be presumed that in some cases the desire of the inhabitants would be overruled, whereas in others exploitation would be disallowed.

Sometimes exploitation, whether of minerals or of any other economic resources, would involve the immigration of a new population. That is a special complication. Populations of mixed race or mixed loyalties may be a source of irremediable trouble. Yet sometimes it will be justifiable to admit them.

In practice in the vast majority of cases a sovereign state will wish to see its material resources exploited to the utmost. The tenacious resistance of President Kruger and his countrymen to the development of the Transvaal gold mines was very exceptional. A more usual source of trouble is the appearance of rival claims for the exploitation of the natural resources of territory the Government of which is quite willing to grant all necessary facilities and concessions, but is too weak to resist any claimant who chooses to resort to pressure. When two rival Powers are both trying to obtain the same concessions, neither will acquiesce in the other gaining the preference by the threat of force, and the outcome may be a conflict between the rivals. That is how colonial wars come about.

4. It may be that an internationalisation of colonies, involving the acceptance of mandates by the colonial Powers for all their subject dependencies, would not as yet be practicable. But even so an international commission for composing economic differences might meet the essential need. To it should be referred all questions arising from a conflict between economic enterprise and sovereign rights, not merely in colonial dependencies but throughout the world, or so much of the world as can be brought to accept an international agreement on the subject.

The composing commission would not be much concerned with legal issues. Its decisions would be directed to practical ends, and it would be for the participating countries to carry them out, and, so far as might be necessary, to legislate.

The composing commission would have to restrict its interference to that really required to achieve its purpose. The general principle should be that the resources of any territory should be worked by the inhabitants themselves. They may however need assistance from outside, capital, labour, technical skill, facilities for procuring or transporting materials or for transporting or marketing their products. If so, it is primarily for them to seek and to obtain it.

It is at that point that the possibility of friction may arise. Any

arrangement for outside assistance is likely to be affected or interfered with by legislative or administrative measures on the part of either of the two or more countries concerned. One useful function of the composing commission would be to invite the Governments of the countries to enter into safeguarding undertakings towards the enterprise so framed as to preclude unfair interference. It would be for the composing commission itself to build up a code of principles defining what is 'unfair,' just as a national legislature, in dealing with private legislation, voluntarily adopts a code of principles which have no authority other than itself. The general idea would be that any measure tending to disappoint the reasonable expectations of any of the parties in the enterprise would be unfair, unless this were the unavoidable accompaniment of attaining some genuine and reasonable public purpose. For example a restriction of the charges of a public utility company (if efficiently managed) below the remunerative level would be unfair, or a suspension of movements of livestock ostensibly on veterinary grounds when no such precaution was really necessary. The composing commission would not collect debts for investors from defaulting borrowers, but it would claim a say as to the extent to which a default was excusable.

There would be cases where the external help needed by a territory in course of developing its resources was offered from two or more competing sources. Ordinarily the competing claims ought to be decided on business grounds, but, if the Governments of the competing claimants begin to exercise pressure, it would be within the province of the composing commission to make recommendations. It would not force a choice on those commercially interested, but it would enter into negotiations with the Governments with a view to preventing any undesirable political reactions.

The case where the initiative in economic enterprise arises outside the territory concerned would also come within the composing commission's purview. Sound safeguards against undesirable exploitation would be needed in the case of a weak or primitive community which has preserved its independent status. The composing commission would claim the right to examine the terms of any concessions granted, and if found unfair, to recommend their revision. If the two countries concerned were both parties to the agreement constituting the composing commission, the recommendation would be binding on them.

The functions of the composing commission might well extend beyond that of securing enterprises of an international character against unfair legislative and administrative measures, and include recommendations relating to matters of general economic policy, such as tariffs, import restrictions, exchange controls, and monetary measures. The participating countries would probably refuse to

surrender their freedom of action in these respects, but they might reasonably agree to consult the composing commission on any new departures, with a view to avoiding injurious reactions on other countries. It would in the long run be in the interest of all countries to act on expert advice so obtained. The general principle would be to recommend such adjustments of any proposed measure as would secure its avowed object with the least possible disturbance of other countries' economic activities. Any country which submitted once to such recommendations would probably find reason twenty times to be thankful that similar recommendations were being submitted to by its neighbours.

No one would pretend that so far-reaching a change in international economic relations could be easily brought about. It would be impossible at the outset to dissociate the decisions of the composing commission altogether from considerations of power and the balance of power. But this would be a recognition of facts, and would in practice make the decisions more firmly founded. The fiction that one State counts for as much as another did not strengthen the League of Nations. Any future international body must be primarily an association of great Powers. What is to be desired is a set of principles by which they are to be guided in the interests of the reasonable economic activity of all nations great and small. They will want to impose standards of fairness on the minor Powers, and standards such as those indicated above would not be too exacting for them to observe themselves.

But economic disputes do not exhaust the possible causes of war. The economic disputes themselves have a political aspect, in that economic resources always count something towards military power. But resources vary widely in their adaptability to the purposes of war, and a conflict of interests may relate not to sources of wealth as such but to something contributing more directly to organised force. It may be a place of strategic value, a bridgehead, the command of a mountain pass, a centre at which several lines of communication converge, a vital seaport, or a naturally defensible frontier. Or it may be the acquisition of arsenals or dockyards or of industries which supply or can be adapted to supply implements of war.

In general *changes* affecting possessions of this kind should not be countenanced, except, in special cases, such as assist defence and not attack. A strategic frontier usually favours defence on both sides. No country ought to seek a bridgehead in a neighbour's territory.

5. If changes affecting strategic points and resources for production of the means of war are to be precluded, that means that existing frontiers are to be to a great extent stereotyped. How far will that be tolerable? The Atlantic Charter looks forward to changes of territory after the present war being made only in accordance with the

wishes of the inhabitants. Inevitably there will be racial minorities, but the existence of minorities will not be a sufficient reason for changing again when *ex hypothesi* there is no alternative available free of minority problems.

But there may be new movements, new cleavages and new loyalties in the future. Irreconcilable conflicts may arise about institutions and be the cause of both international wars and civil wars. Such were the wars of religion, whether between Christendom and Islam or between Catholics and Protestants, such also the militant democracy of the French Revolution forcing peoples to be free. And the American Civil War arose out of the issue of slavery, apart from which secession need never have been brought to a head. At the present day communism has its international appeal for class war and revolution.

Issues of this kind, if they go deep enough, and make devotion to a cause a new bond of loyalty, draw new frontiers. The frontiers are determined by the dominant sentiment of the peoples towards the great issue of the day, and may cut right across national, economic and strategic lines.

A conflict of institutions acquires the essential characteristics of war, actual or potential. Each side counts its resources, each endeavours to outstrip the other in acquiring the material means of organised force. It is a new version of the international anarchy. There is, however, a difference. For the combatants on each side are looking forward not solely to security or ascendancy, but to the accomplishment of an idea which they believe to be beneficial.

Their devotion is therefore not empty like the pursuit of power for its own sake. But the absurdity of the trial by combat is perhaps even more palpable. There could be no more hazardous way of choosing between too alternatives both of which claim to be desirable.

In the case of religion this has come to be recognised, and an escape from conflict has been found in toleration. Toleration is not easy to apply fairly where an established religion has big endowments in which new cults or sects press for a share, or where different persuasions seek to exercise incompatible influences on State-supported education.

But for economic institutions such as slavery or communism a compromise on the basis of toleration is not practicable. The question has to be decided by the government of the country, and a resort to force is surely the worst method of decision. There is no probability at all that success will be on the side that better promotes welfare. Democracy is advocated on the ground that it is better to decide controversies by counting heads than by breaking them. It is easy to deride the assumption that the collective wisdom of a mass of ignorant individuals will throw light on the difficult and intricate problems of the political, social or economic organisation of society. And it

must be admitted that when each voter is guided (as is likely) by a calculation of his own apparent interests, there is no certainty that the result will correspond at all closely with the general welfare. And it *might* be that a minority of enthusiasts, whose faith in their cause is such that they would take up arms rather than accept an adverse decision within constitutional limits, would display greater wisdom than the unwilling majority. But hot-headed minorities suffer quite as much from short-sighted and unsound views of political issues as indifferent majorities, and are even more subject to emotional unreason. A devoted party can gain control of the government of the country by forcibly seizing the reins of power at the executive centre from which the administrative machine is directed and the community is disciplined. That is the significance of a *coup d'Etat*, a stroke at the State, sometimes in the form of a palace revolution, sometimes of a forcible occupation of the essential positions and buildings and control of the administrative staff by coercion if necessary. In case of a civil war the machinery of government has to be to some extent improvised by one side or both, and each must gain sufficient support or acquiescence from the people in the territory it controls to maintain organised force. But civil war is the exception. Revolutions have more often been effected by a sudden stroke and the seizure of the executive power at the centre of government. That of itself gives control of the armed forces, unless they are themselves active partisans of the evicted leaders.

A movement that is international in extent, and aims at introducing some new form of institution in all nations, will seek to establish in any country a Government in sympathy with its views. Sometimes it will be possible to do so by peaceful and constitutional methods, if sufficiently numerous or influential supporters can be gained over in the country. Sometimes a Government amenable to the desired change may be imposed from without by organised force.

Wars of that kind can only be guarded against by mankind learning to be tolerant. That is a lesson that has on the whole been learnt in the sphere of religion. Not that religious differences do not still give rise to the use of violence and coercion, and even appear as an aggravating cause of actual war, as in the Spanish civil war. But in general a wide religious toleration is at any rate the ostensible policy of nearly all civilised countries, and religion has long ceased to be the basis of a balance of power in Europe or in the world.

Toleration may be more difficult to secure in the economic sphere. An institution either is or is not adopted, and a compromise may be far from giving each party a part of what it desires; indeed there may be no practicable compromise that is not emphatically condemned by both.

Communists regard themselves as combatants in a class war, a

struggle of wage-paid workers against profit-makers and their satellites. The payment of ransom in the form of social services does not satisfy them. But obviously it would be disastrous if the communists' class war were to be allowed to develop into an armed conflict. However indifferent the majority in any country may be to the aims of communism, they cannot be indifferent to civil war. Civil war is a disaster to both the successful and the defeated parties, and not less so to those who stand aside. To avoid it must be the concern of the people of the country itself. Nevertheless an international body entrusted with the mission of avoiding war between nations may help in avoiding civil wars which, being about questions extending beyond national boundaries, are likely to spread.

A war of ideas or institutions, no less than a war of nations, becomes a conflict of territories. Each side depends on the resources it derives from the territorial rights it exercises, whether through the normal process of civil government or through military occupation. If there emerges a balance of power, it is a balance of the resources controlled by the antagonists. It only differs from a balance of power among nations because the loyalty that binds the adherents together on either side is devotion to a cause instead of allegiance to a State.

6. It must be admitted that there is no infallible method of avoiding war. The best hope lies in an international body which will point the way out of any dispute, not by a crude splitting of the difference, but by a carefully planned settlement offering the most favourable practicable scope to all the interests involved. The proposed composing commission would be the agency of this body in the economic sphere.

If the recommendations of the international body could be imposed by such overwhelming force that neither party could think of resistance, the solution might be complete. After a world-wide war, when the victorious nations are still united and the defeated powerless, and the people of both detest war, conditions are favourable to giving such a system a prosperous start. If it could be firmly established, and gain not merely the support but the faith of the world in general before the favourable conditions pass, the danger of war might be almost eliminated.

Neither the union of the victors nor the weakness of the defeated can be counted on to last indefinitely. Only so long as the former are united can they enforce conditions of disarmament on the latter. If dissensions are allowed to arise among the victorious nations, their joint forces are no longer available for overaweing any disturber of the peace, whether one of those previously defeated taking up arms again, or another.

That is what happened in the nineteen-thirties, and there is no *certain* way of guarding against it happening again. Even when there is a single conqueror, as in the case of the Roman Empire (which ruled

over what was practically a self-contained world), the peace may be broken by civil wars.

When the economic sanctions on which the League of Nations had relied were found wanting, there was a choice between two alternatives. Either the League must be content to exercise no more than a moral influence, or it must be furnished with the means of employing organised force. The second alternative would mean that all members of the League must arm themselves for the defence of their collective security.

But the mere accumulation of armaments would not be enough. Collective security would mean a permanent military alliance, and the preparation of plans for co-operation in war. A permanent military alliance or merger of organised force in a group of nations approximates very closely to a merger of sovereignty. The authority which directs the combined forces of the group is in effect the sovereign power of all, and the component nations exercise no more than a delegated power over their internal affairs. There is perhaps no great harm in that. The delegated power can be safeguarded by the conditions under which the directing authority is constituted. But if those conditions are narrowly limiting, the use of the combined force on the occasion arising may be hampered. It may be said that the combined force would be used only against 'aggression,' but the League failed to find a definition of aggression. An aggressor may refrain from any course so crude as sending an invading army, and may use the mere threat or potentiality of force to get concessions. Or he may foment a revolutionary movement, to establish a subservient government in the country marked out as a victim. Or he may, by apparently innocent and voluntary agreement, acquire rights, the strained exercise of which can put intolerable pressure on the victim. And if formal definitions and legalistic reasoning cannot be relied on to designate an aggressor, the case for employing the combined force must depend essentially on the exercise of judgment. And either the judgment must be unanimous, or dissentient nations will be put in the odious position of allowing their own organised force to be used in a cause in which they do not believe. Even if they are merely indifferent, that will be fatal to the endurance and exertions claimed by war.

Can a country be expected to enter whole-heartedly into a dispute very remote from its own situation and interests? Can the republics of South America be effectively mobilised to put pressure on a European State accused of aggression? The League when led by European Powers did not succeed in applying any very decisive or clear-sighted measures to the conflict between Bolivia and Paraguay.

It is such considerations that have led some supporters of collective security to propose big confederations of States each of which would maintain its own unified force in support of the collective security of its members, but would disavow any concern in the affairs of the others.

North and South America, it is maintained, could form a self-contained world, and Europe another. But what is 'Europe'? Europe includes the great colonial Powers with frontiers in Africa and Asia. Some supporters of this plan would regard the British Empire as itself one of the big groups, separate from Europe. But how impossible such a separation would be! How can the British Empire disinterest itself for a moment in the appearance of an aggressor in Europe? It is sometimes a matter of hesitation whether the Soviet Union should be thought of as part of a European confederation or not. And it is not very easy to plan a future on these lines for half the world's population in Asia.

But even supposing history, geography and politics permitted a subdivision of the world into a few big confederations, each maintaining organised force to police its own members, what safeguard can there be against disputes between one confederation and another? If there is merely a merging of all the small Powers with the great, that means that the small Powers must be automatically involved in the quarrels of the great, and must take their share in the burden of total armament.

If these confederations are to afford collective security, each must be subordinate to a world system. So understood, they may make a valuable contribution to the practical application of collective security. In case of aggression direct military measures would in the first instance be taken by the confederation in which the aggression occurred, and the rest of the world would give no more than moral and economic support, unless the single confederation failed to assemble sufficient force.

Even under these conditions, there would be a danger that the small and weak nations grouped around the great Powers, and subordinated to them in the exercise of organised force, would lose their independence altogether. Military necessity is a dire tyranny, and when the war prepared for is total war, it cannot afford to be tolerant. Only if the system were so far successful as to make the danger of actual conflict remote, and the organised force maintained relatively small, could the small nations enjoy free scope.

What we must hope for is a sufficiently lively sense of the horror and futility of war and an understanding of the principles of stable settlement of disputes among the peoples of all nations. Much progress had been achieved in that direction in the years following 1918, and even in Italy the appeals of Fascism for a military spirit had not gone very deep.

The nineteen-thirties brought a disastrous reversal and the loss of more than all the ground gained. The cause was to be found in economic distress. The frightful scourge of unemployment, for which Governments and statesmen had no convincing remedy to propose,

gave rise to a state of reckless despair, above all in Germany. The sources of human action are emotional; that is as true of men in the mass as of individuals. In order that a community may be aroused to take positive action to meet some need or attain some desirable object, an appeal must be made to its emotions. A wise Government will take the appropriate measures in good time and avoid provoking such an appeal. But where the measures to be taken become a matter of controversy, and there is opposition of views or of interests, reason becomes merged in feeling. In the economic depression of the years 1930 to 1933, unemployment was not a subject of any ordinary controversy. All parties agreed that everything possible should be done to remedy it, but no party was associated with any particular remedy.

Any policy that really promised a way of escape would have secured overwhelming support and would have prevailed over all opposition. But there was none. Misery and discontent engendered passions, which would have been discharged in meeting opposition and overcoming obstacles, but which were only embittered and intensified by frustration, when there was neither policy nor opposition. The outcome in Germany was desperation, a reckless cutting of knots, National Socialism.

There are many lessons to be learnt from these fateful years. One among them at any rate is that the destiny of mankind cannot be safely entrusted to an economic system which is liable to so disastrous a breakdown.

CHAPTER XV

STABLE MONEY

1. Of the purely economic ills that have vexed humanity in the present century pride of place must be given to unemployment. Unemployment is pre-eminently a sign of failure of the system, not the special unemployment attributable to changes in the character of demand and consequently of the economic activity which supplies it or to other dislocations of economic life, but the general unemployment consequent on a contraction of general demand. The contraction of general demand does not mean a diminution of people's desire or need for the goods that could be produced or of the welfare to be derived from them; it means a diminution of the *money* that people who desire them can offer. Poverty in the midst of plenty is a terrible paradox which everyone can appreciate. If it were indeed, as it has recently appeared to so many people to be, irremediable, the inevitable conclusion would be that an economic organisation which has that result has broken down and must be discarded.

But after all there is every reason to say that the trouble is not irremediable. If, as I have argued above in Chapter VI (pp. 84–7), general unemployment is caused by a contraction of the flow of money relative to the level of wages, it can be avoided by a suitable regulation of the flow of money. Beneath the many-sided controversies that have prevailed among economists in regard to trade depressions and the trade cycle in the past twenty years lies a measure of agreement. Whatever the causes adduced or the remedies recommended, an implication of all theories (though sometimes deeply concealed) is that a contraction of the flow of money is an invariable accompaniment of a depression, and an expansion of the flow of money is an indispensable concomitant of a remedy.

In Chapters V and VI we saw how under the international gold standard, as established in the nineteenth century, alternations of expanding and contracting credit occurred, because the criterion of gold reserves, by which credit policy was guided, always gave the signal for action much too tardily. An expansion which at the outset was needed to correct a previous contraction would proceed far beyond the point at which that object was attained, and a shortage of gold reserves would only appear when the expansion had been going on gathering impetus for several years. By that time, if the reserves were to be restored, it would be necessary not merely to stop the expansion, but to reverse it, and bring about a substantial contraction. Expansion and contraction meant expansion and contraction of the flow of money, and these took place in all gold standard countries in virtue of the inter-

national character of the gold standard. A contraction meant a contraction of the flow of money and therefore of the demand for goods throughout the gold-using world. There resulted world-wide depression, unemployment and falling prices.

Thus conformity to an extraneous standard such as gold may subject a country to the agonies of deflation, depression and unemployment. The variations in the wealth value of gold since 1918 have been much wider than before, and the depressions inflicted on countries adhering to the gold standard in 1921–2 and 1930–6 have been correspondingly severe. The results have been seen in the breakdown and the repudiation of the gold standard. The revised gold parity of the United States dollar provisionally instituted in 1934 has remained operative ever since, but there is no longer any established recognition of the gold standard.

In the absence of any extraneous standard governing the value of the monetary unit, how is its value to be regulated? What principle is to guide monetary policy?

What is wanted above all is to guard against violent or harmful variations in value, and particularly against those variations in value which cause trade depressions. There must in fact be stability of the wealth value of the monetary unit, its purchasing power in terms of goods and services.

Trade depressions are caused by monetary contractions. Monetary contractions are resorted to to raise the value of the monetary unit when it has fallen too low. So it must not be allowed to fall too low. The best way to avoid an undesirable monetary contraction is to take care that there shall never be an undesirable expansion.

That presupposes a standard of what is desirable. We have to interpret what is to be meant by stability of wealth value.

2. It is usual to measure the wealth value or purchasing power of a monetary unit by the inverse of the price level, and to measure the price level by an index number or average of the prices of commodities expressed in terms of prices at a base period. That method of measurement is imperfect in that there are many ways of averaging, and there is room for much difference of opinion as to what commodities ought to be selected. Retail and wholesale prices also give different results. These defects would not of themselves decisively disqualify a price index for use as a practical criterion of monetary stability, and that system has been frequently recommended. If successfully applied, it would certainly eliminate the worst evils of monetary instability.

But the price index has drawbacks, even apart from its statistical imperfections. In the first place an expansion or contraction in the flow of money is not *immediately* reflected in a rise or fall of the price level. The first impact is felt in an increase or decrease of sales of goods from stock and of productive activity. So long as producers

are not employed up to capacity, expansion causes only a very limited rise of prices, and, after contraction starts, there is an interval before the decline of orders to producers leads to price concessions, and a further interval before the price concessions are passed on to the consumers. That does not mean that stabilisation of the price level is a false criterion, but that in applying it foresight would require account to be taken of other symptoms. Intensification of activity presages a rise of prices, slackening of activity a fall. What is required therefore is judgment in estimating whether activity is in course of becoming excessive, and whether a slackening is or is not something more than a transitory spasm. As a matter of practical business it is actually easier to adjust monetary management to the state of economic activity than to the price level. Activity has statistically measurable symptoms, such as the variations of unemployment, which would give as early an intimation of its tendencies as a price index. And the monetary authorities (particularly the directors of a central bank) should be well placed to be sensitive at a still earlier stage to the imponderable factors.

A merely opportunist response to the evidences of activity or depression would not of itself supply a standard. There must be some more tangible standard in the background, to ensure that the measures of expansion and contraction applied from time to time compensate one another, and that the value of the unit does not on balance stray indefinitely in the upward or downward direction. For that purpose the price index, though a good guide up to a point, is not perfect. The prices of particular commodities are exposed to various non-monetary disturbances, and these are not necessarily eliminated in the process of averaging. The index may thus be vitiated as a criterion of monetary policy. If the prices of some big group of foodstuffs or materials are forced up by a temporary scarcity, it would be mistaken policy to treat the resulting rise of the price index as a ground for measures of monetary contraction. Technological progress is constantly reducing real costs of production, at one time of some commodities, at another time of others, so that over any considerable period almost the whole economic field is covered. The fall of prices so occasioned is not a cause of depression. It is consistent with the maintenance of an adequate margin of profit for the producers concerned. Consequently it does not call for a monetary expansion as a corrective, and an expansion occurring under such conditions will have inflationary consequences.

These are causes affecting the relation of prices to costs, and costs may be measured in terms of labour costs. Indeed the other factors of production, the yield of land values and the yield of capital, are both measurable in terms of labour-saving efficacy. If we seek to eliminate from the price index those variations which are due to changes in the relation of prices to costs, what that really amounts to

is that we are looking for our criterion in a stabilisation of the money equivalent of *labour*, instead of in the money equivalent of commodities.

After all, if the subject matter of economics is work, it is natural to find the criterion of the value of a monetary unit in its value in terms of work. On that principle the stabilisation of money will mean the maintenance of just that flow of money or consumers' income which, with the existing level of wages, corresponds to normal profits and full employment.[1]

'The existing level of wages' is not a simple conception. The wages of different occupations differ widely according to the degree of skill called for, the amount of training, practice, and natural aptitudes by which the skill is acquired, the supply of qualified workers at any time in relation to the prevailing demand for their product, and other such considerations. Upon a foundation of reputedly unskilled work-people there is a very complex superstructure of semi-skilled and skilled wage-earners, the relative numbers of whom are subject to such variations that an over-all average has little significance. And even the so-called unskilled have their own special training and aptitudes, and exhibit differences in rates of wages among themselves. Hidden under these complications there is a standard representing the value of the time of an able-bodied man of normal intelligence and faculties.

Happily it is not necessary for the authorities in charge of monetary policy to search for this hidden clue. They can rely on much more summary and empirical methods. As we have seen (p. 230), they are favourably placed to discern those tendencies towards increasing or decreasing activity which warn them that equilibrium is being disturbed, and that corrective action is called for. And prominent among their criteria will be the occurrence of unemployment. They must distinguish the special unemployment arising in particular industries from the general unemployment from which only particular industries and possibly none are exempt, and which is due to monetary contraction. Monetary contraction here means contraction of the consumers' income and of general demand *relative to the wage level.* At a given wage level full employment can only be secured if the consumers' income is sufficient to allow normal profits, or, from another aspect, to engender adequate demand.

At this point monetary policy is in close contact with economic fundamentals. Competitivism relies on profit as the motive of enterprise. Depression and unemployment are caused when a conflict between wage policy and monetary policy encroaches on profit. It should be the aim of monetary policy to avoid this conflict. If it is to do so successfully, not only must credit be relaxed when evidences

[1] See my *Art of Central Banking*, chapter v (reprinted from the *Journal of the Royal Statistical Society*, 1930, Part I).

of depression appear, but credit must be restricted when economic activity shows signs of outstripping productive capacity.

Reaction against the disastrous consequences of deflation in recent years sometimes takes shape in demands for an 'expansionist' monetary policy. Such demands betray a most dangerous misconception. Excess activity is the outcome of an excess expansion of the flow of money, threatening a rise of prices and profits which will put the consumers' income out of harmony with wages, and will lead to a general rise of wages unless it is stopped. If expansions were acquiesced in and contractions never applied, there would be a cumulative monetary expansion carrying both prices and wages beyond any assignable limit, and confidence in the monetary unit and the pecuniary rights on which economic relations are based would be destroyed. Thus if monetary contractions, with their lamentable train of depression and unemployment, are to be avoided, early action must be taken to stop any excessive monetary expansion. Only so can the need for a subsequent *reversal* of the expansion be avoided.

Almost inevitably there would be occasional miscalculations. A monetary contraction would be pressed a little too far, and a twinge of unemployment would give a warning. But if the warning were always promptly acted upon, depression would not develop.

If the monetary unit were in this sense successfully stabilised, there would be no place for *any* change in the wage level, whether upwards or downwards. Changes could legitimately be made in the wages of particular kinds or grades of labour, the remuneration of which happened not to be in harmony with the rest. But theoretically the basic rate to which all other rates of wages are related, the payment for the time of an able-bodied man of normal intelligence and faculties, should remain unchanged.

In practice, whatever monetary policy may be pursued, there is likely to be some bias towards a rise in the wage level in terms of money over any long period. There are always some industries expanding and others declining, while technological progress is constantly bringing new industries into existence. These new and expanding industries have to attract labour, and they are apt to do so by offering better wages, as they can afford to do out of the profits derived from an expanding demand. Labour is at the same time set free from the declining industries, and the wage level in those industries tends under the influence of reduced profits and a superfluity of labour to fall. The two opposite tendencies of wages might cancel out and leave the wage level in the community on balance unchanged. But there is more resistance to reductions of wages than to increases, and the forces making for an increase are likely to prevail. That is not certain. The wage index calculated by Mr. G. H. Woods shows wages in England to have doubled between 1850 and 1914, but that

experience does not of itself prove that a tendency to rise predominates, since the monetary unit was regulated by the gold standard, and whatever expansion occurred was no more than what the gold standard as then worked permitted.

If, however, there is a predominant tendency of wages in terms of monetary units to rise, then monetary policy must choose whether to acquiesce in the rise and allow a corresponding expansion in the flow of money, or to prevent the rise at the cost of monetary contractions severe enough to overcome the resistance to wage reductions.

It would probably be the opinion of many that there is no great harm in a slight and gradual rise in the wage level, even though it represents essentially a fall in the purchasing power of the monetary unit. If the process is no more than what the demands of new and expanding industries impose on the labour market, it is not likely to be rapid or considerable enough to enter in any disturbing fashion into the calculations of those who make pecuniary contracts, even over long periods. And it may be accompanied by technological improvements reducing real costs, so that there may be little or no rise of the price level as a whole.

We have been brought back to the point we reached in Chapter IV (p. 66), where we saw that, when organised labour secures wages above the economic level, it gains nothing. Either an adjustment of the flow of money will cancel the rise against a rise of prices, so that there is no gain in real wages, or there will be unemployment. In the former alternative loss will be inflicted on the owners of pecuniary rights, particularly of incomes from interest or rents, but the gain will not go to the wage-earners but to the profit-makers. In the latter, there will be loss to the profit-makers, and a gain in real wages to those who remain in employment, but that gain is a poor compensation for chronic unemployment.

3. Stabilisation of the flow of money supplies the solution of the problem of depression and general unemployment. That assumes that the monetary authorities have the power to carry it out. Admittedly there are limits to the efficacy of bank rate. On one side inflationary Government finance, if pushed far enough, will create a situation in which nothing that a central bank can do to restrict its lending to other borrowers can avert the fatal consequences. On the other, if deflation is allowed to get out of control, there may result a state of stagnation, in which idle money and easy lending lose their power to evoke a revival of enterprise.

Of inflationary finance there is nothing to be said but that it ought to be avoided, and that, if it is allowed to occur on an extravagant scale, no monetary policy can survive it. The only course left is to rebuild when the storm is over.

Deflation, however, is a direct result of monetary policy. It is the

responsibility of the monetary authorities to avoid it. *Timely action* is the essential condition of doing so. An incipient expansion can be checked by a spell of dear money short in duration and moderate in degree, and the reduction of bank rate at the end of the spell will give a sufficient stimulus to prevent a lapse into deflation. If deflation threatens to persist, a spell of cheap money, promptly applied, can stop it. The essential power to maintain stability of the flow of money is in the hands of the monetary authorities, unless they themselves default by delaying action when the warning symptoms appear.

Timely action is needed, but that does not mean that it must be taken within a week. Once it is clear that action is needed, the more promptly it is taken the better, but usually a delay even of two or three months will not allow a dangerous or even an embarrassing situation to develop. The tardiness of action under the gold standard of the nineteenth century was a matter rather of years than of months. If business starts from conditions of normal activity, with full employment, but profits not in excess of normal, the amount of expansion or contraction that would develop in case of two or three months' hesitation on the part of the monetary authorities would not be very serious.

The occurrence of a violent shock, like the American Stock Market crisis of 1929, might make action urgently necessary, and a fatal misreading of the needs of the situation might once again delay it. But even in that contingency it should be possible to stop the deflation before reaching the stage of a deadlock, if the central bank not only reduced bank rate to a minimum but created a lavish supply of redundant money by buying securities in the market. At such a juncture a delay even of a few weeks might mean a lapse from the policy of stabilisation, to the extent that symptoms of depression would be felt, but if, when the symptoms become unmistakable, the essential and obvious remedial measures are put into operation without further delay, there should be no difficulty in starting an early recovery.

Experience supports the hope that this policy may succeed. There was a noticeable tendency during the nineteenth century for the fluctuations of the trade cycle to become less acute, and this continued in the early years of the twentieth century. It is particularly significant that the period of prosperous activity that prevailed in the years 1911–13 was successfully kept from degenerating into an excessive monetary expansion without the bank rate rising above 5 per cent. The set-back that was appearing in 1914, till the outbreak of war caused a general dislocation, was slight, and, had peace continued, it would have been interesting to see whether a revival would have come about without the intervention of any serious depression.

Even more encouraging is the experience of the American Federal Reserve System during the years when Benjamin Strong was Governor

of the New York Federal Reserve Bank. Between 1922 and 1928 it was a regular practice to raise or lower the New York rediscount rate and to reinforce that measure by the Federal Reserve Banks selling or buying securities in the open market (and thereby extinguishing or creating money), not according to the state of the gold reserves (which throughout the period were far above requirements) but according to the state of activity of business. On the whole, activity prevailed, but it was never allowed to develop into an inflationary monetary expansion. The Stock Market speculation which raged from 1926 to 1929, extravagant as it was, never infected the industrial system with unsound financial conditions. It was the monetary contraction following upon it that turned reasonable expectations of profitable enterprise into illusion.

The pound sterling in the years preceding 1914 and the American dollar in the years 1922 to 1928 were both on the gold standard, and therefore linked to all other gold standard currencies. In fact the stabilising influence of the Bank of England in the former period was felt throughout the gold-using world. In the latter period the United States started as the only remaining gold standard country, and had the advantage for a time of regulating the dollar in isolation from all other monetary systems. Other countries soon reverted to the gold standard, but it was only when England did so in 1925 that the monetary isolation of the United States was materially disturbed. Even then the divergence of English credit policy from American was not such as to produce any serious clash. The breakdown of the American experiment came from within, when the trade recession of 1929, suddenly intensified by the Stock Market crisis in October and November of that year, was not treated with a sufficiently prompt and thorough reversal of the deflationary measures previously applied.

In any future attempt to stabilise a monetary system, the effect on the foreign exchanges cannot be disregarded. The ill repute of the gold standard, which undeniably exists at the present time, is attributable to a lively memory of the way an undue devotion to gold parity has repeatedly involved countries in disastrous deflationary courses. Deflation, involving a deliberate rupture of the relation between wages and prices, with almost inevitably an epidemic of unemployment, is held to be too heavy a price to pay for the preservation of the admitted advantages of an international monetary standard.

This condemnation is not entirely unreasonable. At the same time it is very necessary to distinguish two quite different contingencies which may involve a gold standard country in deflation. On the one hand, any deterioration of the country's exporting power in relation to its imports, through a decline in the productive power of its exporting industries, for example, or a shrinkage of demand in their foreign markets or the intrusion of new competitors, or through a change in

its position as an importer or exporter of capital, may involve it in an adverse balance of payments. On the other, the credit policy pursued by leading centres in other countries may call for a *general* deflation calculated to raise the purchasing power of gold (or in other words to depress prices and wages) throughout the gold-using world. The former is quite a limited problem, and only where the deterioration is substantial and sudden is there likely to be any serious difficulty in dealing with it. If the deterioration is permanent and the adjustment required in order to maintain the existing parity is such as to necessitate a reduction in the level of wages beyond what can be smoothly settled by agreement, devaluation of the currency unit may be the right remedy.

It is a general deflation, raising the wealth value of gold, and requiring the wealth value of all gold standard currencies to be simultaneously raised, that has above all to be guarded against.

It may be contended that the experience of the years 1911–13 or 1922–8 belongs to a past world, and is irrelevant to future plans. But it is the only recent peace-time experience which has been free from the blunders of the years 1919–21 and 1929–39. And the monetary and banking institutions of the world would have to undergo very far-reaching changes to make this experience inapplicable.

4. To guard against general deflation, the best plan would be one of co-operation among the principal credit centres. If they could avoid any such relaxation of credit as would lead to a rise of price levels and wage levels higher than monetary policy would let them remain, deflation would never be required as a deliberate act of policy.

To what extent international co-operation will be feasible in the near or further future it is impossible to say. Failing a concerted policy, the wise course will be for every country or group to aim at its own monetary stabilisation, preferring as a rule an alteration of the foreign exchange value of its currency unit to any serious deviation of the flow of money and the price level from their due relation to the wage level.

The rates of exchange would not be formally fixed. But, as we saw above (pp. 100–1), monetary authorities cannot afford to leave rates of exchange at the mercy of speculators. That does not mean that they must impose foreign exchange control, but that they must hold reserves of foreign exchange and buy and sell foreign exchange at suitable rates.

A monetary authority which does that does not change any rate unless there is a perceptible pressure upon it. The most potent cause of such pressure is a tendency to inflation or deflation in one or other country or unequal tendencies in both. If all the principal monetary groups of the world were separately pursuing a policy of monetary stabilisation, year after year might pass without the occasion arising for any of their mutual rates of exchange to be altered.

Thus the world might drift into a state of stable foreign exchanges based on the separate stabilisation of the wealth value of each of the principal currency units. If the currency units connected by the fixed rates are successfully stabilised, the danger of the groups imposing deflation and depression on one another is excluded.

Such a system, so long as it rests on the separate and independent action of the several monetary groups, is precarious. To ensure its permanent operation, concerted international action would be needed.

A plan for an international stabilising policy was submitted to the World Economic Conference in 1933, and only failed of acceptance in consequence of American hesitation.[1] The principle recommended was that, while the credit system of each participating country should be regulated with a view to its own monetary situation, all should at the same time have regard to the monetary situation of the world as a whole, and should introduce a *bias* towards expansion or contraction as that might require. Thus if there were a tendency towards undue monetary expansion in the world as a whole, those countries with unfavourable exchanges would give full force to whatever measures of contraction seemed appropriate, with a bias towards severity, and those with favourable exchanges would refrain from any positive relaxation of credit and might even incline towards restriction. And in the contrary case of a world tendency towards contraction, the countries with unfavourable exchanges would impose little or no restriction, while the others would adopt whatever measures of relaxation and expansion might be needed to counteract the contraction.

There would never be a general monetary expansion or contraction. Particular countries or currency groups would from time to time find an expansion or contraction necessary in order to adjust their internal monetary conditions to the rates established in the foreign exchange market. But expansion or contraction would not be allowed to spread to other countries.

According to the practice formerly followed under the gold standard, any country which started contracting credit tended to attract gold from the others, and they in turn, on losing a part of their reserves, contracted credit too. Even this system would not have involved a general contraction if an expansion had not previously been allowed in the gold standard countries as a whole, in excess of what the available stock of gold could support.

5. The essential advantage of international co-operation in monetary stabilisation would be that by preventing excessive monetary expansion the need for general contraction and universal deflation would be avoided. That advantage could be maintained consistently with a re-introduction of the gold standard.

[1] See my *Gold Standard in Theory and Practice*, pp. 278–87 (4th edition).

The central banks and monetary authorities of the world are in a position, if they co-operate, to dictate the wealth value of gold. The demand for gold nowadays for any other than monetary purposes is small in comparison with the annual supply. And the stock already held for monetary use exceeds twenty years' output. Thus the monetary authorities are the only important purchasers of gold, and hold the only important stocks. It is within their power to maintain a fixed price of gold by undertaking to buy or sell any quantity without limit at that price. Thereby they can equate the value of gold in terms of wealth or labour to the value of the monetary units in which its price is expressed, and, if the value of the monetary units is stabilised, so is the value of the equivalent amounts of gold. Instead of the value of the monetary unit being determined by the value of gold, the value of gold would be determined by the value of the unit. The one great defect of the gold standard, the danger of fluctuations in the wealth value of gold disturbing monetary equilibrium in the gold standard countries, would be eliminated. That was the aim of the monetary resolutions adopted at the Genoa Conference in 1922.[1]

The vested interests of the gold-holding and gold-producing countries would in any case probably be an insuperable obstacle to the abandonment of the monetary use of gold. But even apart from that there are great advantages in its continued use. Gold provides central banks with an *anonymous* asset to constitute their reserves. Without it they must hold reserves of foreign exchange, composed of debts due to them in foreign centres. Either they must rely on the credit of commercial banks or traders, or they must hold obligations of public authorities, such as Treasury bills and balances at foreign central banks. Even these are not always free from the risk of default, and in any case they are at the mercy of monetary legislation. Even if they are not put out of action by exchange controls, moratoria or 'freezing' or 'blocking' measures, the unforeseen weakening of a foreign currency unit may make the reserves held in it useless.

And when each of two countries holds a reserve in the other, while they are sufficiently equipped to regulate the rate of exchange between themselves, they will find, when they draw on the reserves to support the rates in a third country, that each is obtaining resources only at the expense of the other. For that purpose in fact the reserves cancel out.

Unless there is one great centre with a pre-eminently strong exchange position, in which all reserves can be held, every monetary group must take care to maintain a separate reserve in every other. But no great centre is beyond suspicion. Both the pound and the dollar have been found to give way under pressure; and balances in

[1] See my *Gold Standard in Theory and Practice*, pp. 113–19 (4th edition).

the United States have been frozen, and exchange control has been imposed in England.[1]

If gold is to be eligible as a reserve asset, its price in terms of the currency unit must be fixed, and the purchase and sale of gold by the monetary authorities on the basis of a fixed price is the essence of the gold standard.

The price is not entirely within their arbitrary discretion. Too high a price would stimulate the output of gold from the mines and limit its use in industry, so that the accumulation in the hands of the monetary authorities of the world would become burdensome (as indeed it already has in the United States). The accumulated gold reserve has to be paid for, and payment eventually is not a mere book entry but a real cost. Too low a price might result in so serious a falling off in the output from the mines, and so considerable an increase in the industrial use of gold, that the accumulation might be insufficient, and might even begin to decrease. A deficiency of gold could be made good by a more extensive resort to foreign exchange reserves. But it is desirable to fix the price of gold at the outset at a level where, so far as can be foreseen, it can stay. Changes in the price of gold are bound to have a disturbing effect, especially as they always have to be made without previous notice, in order to avoid speculation.

The trade depression of the nineteen-thirties, more than doubling the value of gold in terms of other forms of wealth, gave a great impetus to the output of gold. Fears that had previously been expressed of a great decline of output from the mines were soon dispelled. The increase in output did not materialise in time to give any considerable relief before the crises of 1931 and 1933 threw first England and then the United States off the gold standard. And after the United States resumed the purchase of gold in January, 1934 (at a fixed price in dollars 69 per cent. higher than before), there was an ever-growing confluence of gold thither, till the country on entering the war in December, 1941, held the enormous total of $22,700 millions. No other country was an effective buyer of gold.

From time to time the anomalous gold position gives rise to some searching of heart. The United States Treasury keeps the price of gold up to $35 an ounce by buying all that offers at that price; if it ceased to buy, the price of gold would drop. To what level? It is impossible to say. After the crisis of 1931, which drove England off the gold standard, there was a demand for gold from private individuals for hoarding purposes. The purchase of gold for hoarding was a speculation on gold maintaining its value better than assets based on

[1] Recent proposals for an international Clearing Union or Stabilisation Fund (the British *bancor* or the American *unitas*) are intended to meet the need, but they are primarily designed for economising the use of gold as a monetary reserve, not for dispensing with it.

currency units which might suffer indefinite depreciation, or on enterprises which might be ruined by trade depression, war or revolution. So long as there was a hoarding demand, the value of gold did not depend wholly on the American buying. But there is the possibility that, if a cessation of American buying precipitated a heavy fall in the market price of gold, there would result such a distrust of the future value of gold as to put a stop also to the demand for it for hoarding purposes. If that occurred, the demand for gold for use in industry (for plate, jewellery, etc.) is not of a magnitude to do anything appreciable to fill the gap, and the fall in the value of gold might well be catastrophic. That prospect is itself a powerful deterrent on the suspension of American buying, for the Americans would be unwilling to see their huge gold holding depreciated to a fraction of its original value. And the effect on the great gold producers both in the United States and in South Africa and elsewhere would be disastrous.

If the use of gold for monetary purposes, as a reserve to be drawn on to meet an adverse balance of payments, can be revived, this contingency may be avoided. After the war it may well be that the United States will be left, as a consequence of the tremendous economic effort that the war involves, very short of a variety of commodities, and that the countries in a position to export these will be willing to receive payment in gold. And if the United States gives financial aid to some of the distressed countries, the aid may take the form of payment to third countries better circumstanced to send the required supplies. If in these and other ways a great part of the American superfluity of gold is dispersed, it should not be difficult to restore the use of gold reserves. But the prevailing discredit of the gold standard is so far justified that a return to the blind adjustment of the flow of money to the supply of gold ought not to be contemplated.

The reinstatement of the gold standard is a side issue. The primary ends to be attained by monetary policy are, on a long view, the avoidance of deflation with its consequence of depression and general unemployment, and the avoidance of those restrictions and controls which are imposed on the foreign exchanges and on international trade when a country is unwilling to face the choice between deflation and depreciation.

No objection is likely to be taken anywhere to the continuance of American purchases of gold at $35 an ounce. Other countries will be under no obligation either to purchase or to sell gold, and can reserve their freedom to adjust their rates of exchange in any way that may seem desirable. But if they drift into unvarying rates, their monetary affairs will proceed with a minimum of controversy. Having in fact a fixed price of gold, they will please those who hark back to their old devotion to the gold standard, and, retaining a free hand to regulate

credit with a view to avoiding both inflation and deflation, and if need be to depart from the fixed price, they will please the enemies of the gold standard. The chief danger will be that monetary authorities will come in course of time to think that a gold standard can manage itself, and that no positive interference is needed to maintain stability of the flow of money. That state of mind might let the world in for inflation and deflation on the catastrophic scale once again. Not only does a gold standard, if not wisely managed, permit of an uncontrollable deflation developing. It is no real safeguard against inflation, because an inflation proceeding throughout the gold standard countries can go far before an actual shortage of gold is felt. And in any centre where inflation gets out of control the gold standard is sure to be promptly suspended.

6. In the situation immediately following the end of the present war, however, many countries will find themselves confronted with a need of the greatest urgency, the prevention of an extravagant inflation such as occurred in the greater part of Europe after the war of 1914–18. War finance under the conditions of the present time is bound to be inflationary. No fiscal machinery can be devised to pay for the gigantic expenditure by taxes and loans drawn from income, and the difference is made up by a creation of bank credit. While the war continues, the effects of inflation can be to a great extent suspended or at any rate masked by various restrictions and controls. Supplies for civilian consumption are limited through controls both of imports and of home production. The restriction of supplies would, taken by itself, force up prices and aggravate the tendency to inflation, but price controls and, where practicable, the rationing of supplies intervene, so that people are compelled to save, simply because they cannot find objects to spend their money on. The result is first that stocks of goods are used up and then that savings accumulate in the form of loose money which, being destined to be spent as soon as opportunity offers, is withheld from investment in any permanent or long-dated securities.

As soon as the restrictions upon imports and production are relaxed, and the depleted stocks of goods in traders' hands begin to be replenished, idle money will be released and will give rise to a volume of demand which, at the existing price level, will soon far exceed current fresh supplies. It may be extremely difficult to make a control of prices effective in face of this demand, and, if the rise of prices becomes considerable, there is likely to be irresistible pressure for a corresponding rise of wages and salaries. If a fresh creation of money (whether currency or bank credit) can be prevented, the rise of prices and wages may be brought to a stop when the flow of money is sufficiently enlarged to be in a normal proportion to the stock of money. But it is only too likely that, as fast as prices rise, credit operations for

the purchase and holding of goods will expand in proportion, and the supply of bank credit will be indefinitely increased.

Much has been written about the 'vicious spiral,' how prices push up wages and wages push up prices without limit. That in itself is not necessarily caused by a preceding monetary inflation, but may result from a scarcity of supplies. If there is a scarcity of some staple commodities, and the resulting rise of prices increases the cost of living, a rise of wages (unless it results in unemployment) will merely restore the demand at the higher price level to what it previously was at the lower, and a further increase in the price level becomes necessary to restrain consumption. The monetary factor comes into the process because, if, despite the rise of wages, the flow of money is kept unchanged, profits will be encroached on, productive activity will fall off, and unemployment will supervene. But a rise of wages may of itself involve an expansion of credit, for traders will have to procure more money to cover their costs. Positive action would be necessary to counteract the expansion.

If instead of a scarcity of goods there is at starting a superfluity of money, the effect is the same. The scarcity of goods relative to the supply of money forces up prices and, if wages are then put up, the relative scarcity is accentuated. But there may be a difference, in that when there is already a superfluity of money, it may not be necessary for traders to raise additional bank advances. The rise of prices and wages, if it proceeds without any addition to the supply of money, tends towards a limit, at which the wealth value of the monetary unit will be so far depreciated that the supply of money representing a proportionally diminished command of goods and labour is no longer redundant.

Nevertheless the creation of credit is very apt to be accelerated even when the aggregate supply of money is already redundant. For if the expansion of demand gives rise to an expectation that prices will go up, there is a tendency to accumulate stocks of goods with a view to future gain. It looks profitable to become a debtor in money and an owner of goods, if the goods are expected to represent an increased sum of money later on.

The conditions of war cause both an actual shortage of supplies and *also* a redundancy of money, and the belligerents will find themselves faced, when it is over, with the need of eliminating the redundancy of money. Any country which fails to do so runs the risk of a reduction of the wealth value of its monetary unit to a small fraction of what it was, or in an extreme case may suffer a complete collapse of its monetary system. The confusion which a violent depreciation of the monetary unit introduces into economic relations was exemplified in the ordeal Europe went through in the years 1919–23. Not only are all creditors' rights written down, possibly to a derisory fraction

or even practically to zero, but the settlement of all prices, and especially of wages and salaries, becomes a matter which calls for daily or hourly reconsideration, and in which no standard of fairness or expediency can ever be discerned. Creditors' rights moreover include not only the big fortunes of the rentiers, but the life insurances, annuities and savings deposits of the thrifty middle class and wage-earners. Indeed it is on these latter that the loss chiefly falls, for (as death duty statistics clearly show) it is in general the rich man, and not the poor, who possesses shares or landed property the value of which is not governed by that of the monetary unit.

Of the vital importance of preventing this state of things from occurring there is no room for doubt. As to the measures to be taken a volume might be written. The machinery of bank rate and reserves of foreign exchange, which works well enough in quiet times, is only too likely to prove inadequate to cope with the accumulated force of the inflationary finance of several years of war. Nor can reliance be placed on the controls of markets and of transactions, once the unity of aim characteristic of war has lapsed.

Recourse must be had to fiscal expedients on a heroic scale. A continuance of war taxation at its height may not suffice. A hundred per cent. excess profits tax, preventing traders from retaining the gains made by an inflationary rise of prices, may help, but it has the danger of removing the immediate motives for resisting pressure for a rise of wages.

The solution is probably to be found in the direction of a forced loan. A forced loan has the advantage over a levy on capital that exact equity in its assessment is not necessary. Those who pay it receive an asset which should be a fair equivalent, and one who thinks he is being required to subscribe a disproportionately heavy amount can console himself with the reflection that he is not suffering any reduction in his total resources.

The purpose of the forced loan being to collect and extinguish the redundant money in the hands of the public, there would be an advantage in assessing it directly on the money or liquid assets held. After the war of 1914–18 more than one country in eastern Europe adopted the device of requiring everyone to surrender half the amount of currency in his possession, and handing out interest-bearing bonds in exchange.

That method could be extended to bank deposits, a half or any other proportion of which could be transformed into bonds by a stroke of the pen. To enforce the surrender of the currency, the plan adopted in Czechoslovakia was to require every individual note to be cut in half, one half continuing to circulate for half the original value, and the other half becoming eligible as a contribution to the forced loan and for no other purpose.

The extinction of redundant money by a forced loan would have to be accompanied by credit restriction in the form of dear money and any other suitable measures, in order to prevent the money extinguished from being replaced through bank advances creating fresh credit. Given sufficient credit restriction, there need not be any restraint on the selling or pledging of the bonds.

Wholesale deflation of this kind demands very careful handling. If carried too far, it may cause a calamitous depression. As soon as it has definitely accomplished its object, the credit system will become normally susceptible to bank rate and other deflationary measures. It might be supposed that the scarcity of goods and the arrears of capital outlay would ensure a persistence of activity. But that is not so. A sufficiently drastic contraction of the flow of money could produce idleness in the midst of scarcity no less than poverty in the midst of plenty.

Experience after the war of 1914–18 has given rise to the idea that war is naturally or even inevitably followed by depression. That is a misconception. The depression that started in 1920 was the result of deliberate policy. Deflationary measures of an exceptionally severe kind were resorted to in the spring of 1920 both in London and in New York. They were indeed unavoidable at the moment, for inflation had been allowed to get out of control. But the 7 per cent. bank rate was kept on for many months after it had clearly accomplished its object, and a far more severe depression resulted than need have occurred. Deflationary measures applied a year earlier could have prevented the inflation from taking hold, without ever going to the length of causing depression. And the depression that occurred a century before, after Waterloo, was also due to a deflation which raised the pound to gold parity.

No simple criterion can be relied on to give warning when the deflation imposed to check a post-war inflation is going too far. If all pressure for increases of wages has ceased (except in particular cases where wages are out of trim with the rest), deflation has gone far enough ; and if unemployment appears (apart from that due to special causes of dislocation, such as a shortage of plant or materials or of complementary factors in particular industries), deflation has gone too far and ought to be reversed. There is no need to dwell on the difficulty of judging, but it is better to err by missing the mark than not to aim at the mark at all. To do nothing while a torrent of inflation sets in and is visibly swelling in depth, speed and fury, is as disastrous as to persist in applying deflation after the evidence of growing depression has become clear. Both mistakes were made in the years 1919–22.

7. Blunders may be made, and calamities suffered, yet the countries that lapse into inflation must eventually reconstruct their monetary

institutions, and then the adoption of a stabilising principle becomes a practical matter. Whatever the economic system may be, whether primarily competitivist or collectivist or something intermediate or different from either, a stable currency is a vital condition of its working.

Yet any proposal aiming explicitly at a stable currency is likely to encounter opposition. Economic doctrine on the subject is not ordinarily presented in a form to give authoritative support to a Government or a central bank endeavouring to devise a policy; it is perpetually diverted to the consideration of reservations and non-essentials, and so far as economists are interested in the fundamental business of regulating the flow of money, it is chiefly in raising difficulties which they do not solve. A change has come over the spirit of economic science. The economists of the nineteenth century supported many gross errors of theory. But they did not lose touch with practical affairs, and their theorising was usually modified by a salutary infusion of common sense, so that the practical advice they gave was better than the theoretical grounds on which it was ostensibly based. And along with the virtue of common sense they possessed faith; they were not afraid of applying their own conclusions, and when they offered advice they carried conviction.

Their successors of the twentieth century are too prone to pursue niceties of theory far out of touch with practice, and only to resume contact with men of affairs to the extent of tossing them paradoxes and disillusionments calculated to perplex and paralyse action rather than to form and support a policy.

The war has made a difference. It has raised fundamental economic issues, on which economists have been able to advise with less disagreement and more conviction. But will they approach the complexity and multiplicity of questions posed by the return of peace in the same spirit?

This matter of money occupies a central position in the economic field. The treatment of any other economic problem presupposes some sort of orderly settlement of the problem of money. That money is of the form and not of the substance of economic life is a commonplace. And so long as the monetary system functions smoothly, it can be excluded from the consideration of those affairs which are of the substance, work, wealth and welfare. But only so long as it functions smoothly. Monetary disorders in the economic system are as far-reaching as nervous disorders in the physiological.

There is no aspect of economic science on which economists have written so much in the past twenty years as that of money. But the result has been deplorable. The only positive proposal even for mitigating the calamities of unstable money which commands any general support is that of Government expenditure on public works. As an expedient for some alleviation of a depression which has become

exceptionally severe and uncontrollable, there is theoretically something to be said for this (though the practical experience of the United States in the six years 1933–9 does not support it). But it starts from the postulates of an abject fatalism. It assumes that the uncontrollability of the depression of the nineteen-thirties, which was the unprecedented result of unprecedented bungling, is something normal, calling only for acquiescence tempered with palliatives.

But surely a recurrence of the calamities of unstable money, the frantic convulsions of inflation, the agonies of deflation, depression, bankruptcies and defaults, dislocation of international trade, above all, unemployment, could only be regarded by an impatient public as a breakdown of the economic system and as an urgent call for a revolutionary change. A change to what? Inevitably to a cutting of knots which there is no time to disentangle. Totalitarian discipline may be invoked, but discipline must be directed to some end. What claim is to be made by the authority aspiring to impose the discipline?

The discipline of National Socialism has been directed above all to war. If peace, when it comes, is to be nothing better than the prelude to another war, that prospect will govern the whole realm of politics and economics. If, when that terror is successfully dispelled, totalitarianism is to be resorted to, it must be totalitarianism of some other brand.

National Socialism has never had to devise a monetary policy for true peace-time conditions. Government expenditure on a war-time scale started almost at the outset of the party's rule in Germany, and the aim of monetary policy was confined to preventing the tremendous financial strain from causing an uncontrollable inflation. For that purpose controls of the type appropriate to war time were relied on. Both wages and prices were effectively limited. Profits were heavily taxed, and a limitation of dividends was almost equivalent in its immediate effects to an excess profits tax. The spending power alike of wage-earners and of profit-makers was thus severely circumscribed. Foreign exchange control of the closest kind prevented any visible depreciation of the monetary unit.

Such measures are not practicable as a permanency. A stabilisation of wages is indeed a necessary condition of the stabilisation of the monetary unit. But a stabilisation of wages when profits are unlimited is hardly to be contemplated. Nor is a limitation of dividends permanently consistent with unlimited profits. In Germany the undistributed profits were required to be placed in Government securities, and, unless at some stage the securities could be realised, and the proceeds used for the benefit of the proprietors or shareholders, the profits would be practically confiscated. The limitation of prices, if extended over all goods and services, accomplishes a limitation of profits, but, unless the flow of money itself is limited, the result is to

exhaust stocks of goods, and to do so all the more quickly if (as is inevitable) imports are restricted. All these expedients are appropriate to conditions in which Government expenditure is swollen to such dimensions as to overstrain the fiscal organisation, and to force the creation of redundant money. The controls and restrictions keep the redundant money penned in balances by limiting the opportunities of spending. A state of things in which prices are kept permanently out of equilibrium, and demands are unsatisfied, is hardly a possibility.

If Government expenditure reverts to the limits within which the fiscal system can sustain it, and the redundant money is eliminated, controls and restrictions will no longer be a sufficient means of stabilisation. They can, it is true, be reimposed in case of a threat of inflation, but the threat of inflation must be removed if they are to be withdrawn. Nor would they do anything to mitigate a deflation. A control of wages might be used to reduce wages to a level corresponding to the flow of money, but that would not of itself end the deflation, for there might be a further contraction of the flow of money. And a practice of changing wages from time to time to suit the vagaries of an unregulated flow of money would be the very reverse of stabilisation.

If the imposition of controls and restrictions on a primarily competitivist economy is insufficient to solve the monetary problem, does that mean that the demand for a cutting of knots will be directed towards collectivism? The collectivist State is the sole industrial employer, and can fix wages by decree. Its executive arm decides what things shall be produced and put on sale and at what prices. It creates money in the process of production and extinguishes it by the sales of the products. The delicate, almost treacherous, credit apparatus by which the creation and extinction of money are regulated in a competitivist society can be dispensed with; an excess or deficiency of general demand can be corrected either by a general increase or decrease of prices or by a general decrease or increase of wages, and the choice between the two can be guided by the state of the outstanding supply of money.

Here also wider issues are raised. All that needs to be said in the present chapter is that so long as pecuniary contracts lasting over an interval of time exist, fluctuation of the value of the monetary unit cannot be a matter of indifference.

CHAPTER XVI

WAGES AND PROFITS

1. The competitivist system has been assailed during the present century from many sides. Even before 1914 weaknesses were being revealed. At that time the defect that attracted most notice perhaps was the tendency of the large-scale units required by the technological developments of industry to give rise to monopolies. When the conditions of an industry make the intrusion of competitors to all intents impossible, the salutary influence of competition is removed, even though there be no legal monopoly. Attempts were made, particularly in the United States, to prevent the formation of monopolistic concerns, and to reinstate competition by an interference that was a departure from let-do.

In reality this growth of monopoly was not so great a danger as it seemed. The power of the big concern being founded on large-scale production, the policy pursued was almost bound to be one of selling at the lowest price to which demand would respond. It might well be that this was actually *lower* than the price at which a number of smaller competing concerns would have sold.

There is in fact a taint of monopoly about profit itself, however competitive it may be. The appearance of new competitors in any industry is conditioned not only by the possession of capital and technical competence, but by the prospects of selling power. There is thus an inherent limitation of competition in virtue of which the existing participants in the industry respect one another's profits. They have the privilege of sharing in the existing selling power, and they refrain from price-cutting and from disproportionate pushing of sales. The ruthlessness of the monopolistic concern is usually rather in the suppression of competitors than in extortion from consumers.

The abuse of profit-making is in the excessive individual incomes it may give rise to. But an enterprise large enough to create for itself the practical monopoly of an industry will transcend the limits of any individual's capital. It will have to raise capital by public issues in the investment market and will have thousands of shareholders, and in buying up its competitors will allot its own shares to their shareholders. The promoters, it is true, in some cases make gigantic fortunes for themselves, but these are derived from the initial process of bringing the large-scale enterprise into existence, and may even be eventually invested for the most part outside it. The big fortunes represent capitalised profits paid for by the incoming shareholders. The promoters may still remain considerable shareholders, and may

continue to participate in the management, perhaps to dominate it. But the monopolistic profits currently earned will be widely distributed.[1]

These practical monopolies are no longer regarded as a serious blemish on the competitivist system. They conduce rather to its smooth working than to its breakdown. The big enterprise, whether a single concern or a cartel unifying the action of a group of concerns, is better placed to consult with the Government and to take wide views of the national interest than a large number of independent concerns.

As we have seen in earlier chapters, the other disorders of competitivism were making themselves felt before 1914, but none in a form which threatened a breakdown. The international anarchy was accepted and unquestioned, as it had always been. Aspirations after internationalism and disarmament were hardly taken seriously. It was almost a matter of course in international relations that the threat of war should be always latent and sometimes overt, and that the public everywhere relied on the opportunist skill of diplomacy to avoid conditions arising in which the threat would have to be carried out. That technological progress portended total war, in which not only the whole manhood but the whole resources of the combatants would be engulfed, was not suspected. The change was first revealed by the shortage of munitions on both sides in 1915, and the severe regimentation of industry that became necessary to make it good. But the full significance of total war was not realised till the renewed competition of armaments set in in 1935 and the succeeding years.

That unemployment was a serious fault in competitivism and in the rule of let-do was widely recognised. But the malady was never clearly diagnosed. There was a 'trade cycle,' accompanied by a periodical recurrence of depression, and the trade cycle was first discerned in a periodical recurrence of financial crises. Each such crisis was seen to be the culmination and collapse of a preceding period of over-expanded credit and excessive activity, and was the immediate result of measures taken to check those conditions. The measures took the form of restrictions on the creation of credit by a high bank rate and other means, and it was recognised that credit restriction caused unemployment. Yet the possibility of smoothing out the trade cycle and avoiding unemployment by a better administration of the control of credit was never envisaged. There was, as we have seen (pp. 234–5), some progress, but the progress was empirical, and there was no conception of co-operation between the credit sphere and the labour sphere. In the eyes of the Bank of England credit was a limited field of action, within which the essential need was to prevent unsound conditions arising such as might threaten the gold standard. To the

[1] The growth of the Ford motor-car concern to gigantic proportions on its own reinvested profits without any public issue of shares or bonds was a very exceptional phenomenon.

workpeople and those concerned in their welfare the trade cycle with its recurrent plagues of unemployment was an act of fate. Unemployment became a stick to beat any undesired policy with. Protection and free trade, extravagance and parsimony, trade unions and monopolies were all accused of causing unemployment.

But in those days neither monetary policy nor unemployment was conceived of as a possible cause of a breakdown of competitivism. Profit-making was in some aspects an object of attack. The influence of Marx persisted, and collectivist movements were spreading and growing. Here was an avowed challenge to competitivism, though socialist parties, when they gained a footing in practical politics, were apt to relegate most of their collectivism to Utopia.

2. Economic inequalities were felt to be a grave defect in the social system, and the policy of heavy direct taxation and expenditure by the State on social services was evolved to mitigate them. But the manner in which profit-making caused the inequalities was not grasped. Those actually engaged in industry, both traders and workpeople, were familiar with the nature and function of profit. But economic theory had failed to find a place for it. There was no coherent *doctrine* of profit to take the place of Marx's crude reasoning. That meant not merely that economic science had no constructive policy to offer, but that it was unable to apply a corrective to the fallacious principles frequently appealed to in the course of controversy.

Economic science had constructed a theory of wages. Every industry, it was held, would increase its production and the numbers it employed up to the limit at which the selling value of the additional output to be derived from employing an additional man would no longer exceed the cost of employing him. At the limit wages were said to be equal to the 'marginal' product of labour. An elegant formula, but defective in allowing nothing at all for profit! Hardly therefore a good foundation for advice on the wages question. In recent years the formula has been modified to take account of 'imperfect competition,' which allows for some variation in the price received by a trader when he makes an alteration in the output he has to dispose of, and his competitors change neither price nor output. That is a step nearer to reality, but the profit margin it allows may be small or non-existent. It fails to supply a theory of profit in accord with practice, and therefore still fails to throw light on the determination of wages.

The wages question, or more comprehensively the question of the remuneration and conditions of labour, was inevitably linked with the profits question. And it was here that really deep-seated defects in the working of competitivism were disclosed. Organised labour was on the look-out for any opportunity of gaining a rise of wages or an improvement of conditions, and the power of employers to grant

what was asked depended on their profit margin. Any settlement presupposed some standard of what was a reasonable profit margin. The standard was empirical. It could only be derived from actual or customary profit margins, and had no precision. Workpeople engaged in bargaining with employers in any industry usually did not know what the actual profits were. And anyhow the actual profits were sure to vary widely as between one employer and another.

In such conditions of uncertainty it was rarely possible to say with confidence whether a claim was or was not just and well founded. The essential materials for a settlement by arbitration or conciliation were lacking. An arbitrator could at best only devise a compromise not intolerable to either party, and that was only too likely to mean that he would split the difference, so that whichever side made the most exorbitant demands would get most.

A dispute which could not be settled by the voice of reason was never far from developing into a trial of strength, in other words a strike or lock-out. So long as strikes were isolated and local, affecting only a single employer or a group constituting a small fraction of the industry, the harm done was confined to the parties themselves. The loss was regrettable, but such disputes were no more than one of those minor causes of friction to which any economic system is liable.

But as we saw in Chapter IV (p. 70), disputes could not be kept within those limits. Combinations both of labour and of employers extended to entire industries, and a stoppage of work bringing an important industry to a complete standstill might do serious injury to the community. That put a dangerous power in the hands of organised labour, a power of threatening or intimidating the community with a view to extorting concessions from the sovereign power.

What causes disputes to lapse into these violent methods is *the absence of any recognised principles* on which a settlement commanding general assent and confidence could be based. When reason is in default, action is frustrated, paralysed. The will is baffled, and is prone to find an outlet in violence. Here is just such an *aporia* as we found to arise with unemployment. There is a knot which people cannot untie, and which they are tempted to cut.

In effect it is the same puzzle over again. Whatever theory of wages may be favoured, there must be a limit beyond which wages cannot be raised. If wages are pushed beyond the limit, the penalty is unemployment. To restore equilibrium, an expansion of the flow of money in proportion to the rise of wages is required. But that will mean a proportional rise of prices and profits. All are where they started, except that the purchasing power of money is diminished and creditors and possessors of pecuniary rights have suffered loss.

A sufficient prospect of profit is a prerequisite of enterprise, and therefore of economic activity and full employment. The limit is put

to encroachments of wages on profits when the inducement to enterprise is impaired, and unemployment supervenes.

3. Thus the problems of wages, profits, unemployment and money are *all one*. To ensure full employment there must be a flow of money sufficient in proportion to the level of wages, but wages also must not be changed when the flow of money has been well adjusted, or the adjustment must be made over again. The ideal solution would be that in which wages never change, and the flow of money is kept permanently just at the level appropriate to wages. That is a simple principle, but its application would be far from simple. As we saw in the last chapter (p. 231), wages are not a single uniform rate, but have to be adapted to every kind of grade and skill and to the special circumstances of different industries.

The 'level of wages' cannot even be suitably defined as an average. There may be, and is very likely to be, a change in the relative proportions of different grades. Technological progress is constantly substituting machines for the simpler forms of labour, and to that extent there is an upgrading. Workpeople who would have found employment in the occupations thus displaced qualify themselves for more skilled or responsible work elsewhere. There may also be displacement of highly skilled labour, either because machines are invented to perform the actual processes, or because the competition of machine-made products destroys or curtails the demand for superior but more expensive hand-made products. New industries grow up employing new kinds of skill.

And it is not a question only of different grades and degrees of skill and responsibility. Industries wax and wane, and, as their demand for labour expands or contracts, the market value of the kinds of labour they need tends to rise or to fall.

We have already seen that there is likely to be a progressive tendency for wages gradually to grow higher (above, p. 233), and it would not be easy to devise a plan of wage settlements that would altogether prevent that. But if the rise of the general wage level is limited to that due to the occasional pressure of new or expanding industries on a labour market which at the same time has to find employment for hands displaced from declining industries, the rise ought to be very gradual and slight. The only objection to a progressive rise of wages is that it involves a proportionate fall in the wealth value of money. But if technological improvements (which are the principal cause of the readjustments of the labour market) continue to increase productivity, the fall in the wealth value of money may be more than outweighed by a reduction of the cost of production of commodities, so that the wealth value of the monetary unit, if reckoned in terms not of labour but of material products, may actually be found to have risen.

Demands for increased wages, if they extend beyond asking for the

levelling up of rates of remuneration alleged to be below what is appropriate to grade or skill, are usually prompted either by a belief that the employers' profit margin has been so augmented that the industry can afford to pay more, or by a rise of prices affecting the cost of living. A monetary expansion, taking effect in an increased flow of money, brings about both these conditions. In the absence of a monetary expansion, if the flow of money is duly stabilised, a rise in the cost of living may still occur, but only through a shortage of supplies, for which increased wages would be no remedy, and an augmented profit margin would still be possible, but only in the specially prosperous industries.

The continuance of wages unchanged, except in industries which are especially prosperous or declining, would in reality be no great innovation. It would be the line of least resistance. Even in nineteenth-century conditions, in spite of the ebb and flow of the trade cycle, there were many industries in which wages remained unchanged for years together. The times of labour unrest were those of expanding or contracting business, not those of relatively stable business.

Yet if the wage level is to supply the standard for the value of the monetary unit, and thus for all the pecuniary contracts which form the economic structure of society, can the determination of the wage level be left to the haphazard of bargains between employers and workpeople ? The stabilisation of money will eliminate what have in the past been the principal grounds for altering the wage level, but there is no certainty that demands will not be made. Labour leaders are naturally inclined to press for the highest wages they can get employers to agree to. Under conditions of normal activity the prosperous and expanding industries will be making more than normal profits. If they concede wage increases up to the limit at which their profits are no more than normal they will be setting a standard which the less prosperous industries cannot afford to follow. If the labour market corrects this disparity, these industries will become unprofitable and unemployment will supervene. That can be set right by a monetary expansion, but then the process will begin all over again.

That this danger is not imaginary is shown by the American experience of the years 1936–37, when a revival of activity was not only checked but reversed by a general increase of wages in manufacturing industry, which in nine months raised the average hourly wage in the twenty-five principal industries from 62 cents to 71.[1]

It is in the immediate interest of every group of workpeople to secure higher wages, and a concession to any group becomes a precedent for increases to the rest. There seems to be an imperative need for an independent body to judge demands from the point of view of the community as a whole. If organised labour could be relied on to

[1] See my *Gold Standard in Theory and Practice*, pp. 201–2 and 207–10 (4th Edition).

accept the view that a universal advance of wages is no gain, and merely necessitates a monetary expansion and rise of prices if unemployment is to be avoided, that might suffice. Otherwise the remedy would seem to be a judicial tribunal to determine wages by legally enforceable decisions.

Wage-earners, it is true, would have to look to a fall of prices instead of a rise of income to give them the benefit of improvements of productivity and reductions of costs, and it may be objected that there would be nothing to prevent the profit-makers from intercepting the benefit for themselves. But the circumstances in which these improvements are made usually require an expansion of sales, which can only be secured by reduction of the price to the final purchaser. And, in any instance where that is not so, and the first result is to increase the profit margin, there would be nothing to prevent a rise of wages being demanded.

A monetary policy which would achieve this result would put a heavy responsibility on the monetary authorities, a responsibility which, as we have seen (p. 13), they are always unwilling to acknowledge. But whether acknowledged or not, the responsibility is there. Without entering upon controversies as to the causes of any particular trade depression, it is beyond controversy that deflation, if it occurs, does cause depression. Even if deflation had never yet been inflicted on a monetary system, it would nevertheless be deducible on theoretical grounds that a monetary policy directed to bringing about deflation would if successful involve depression with all its attendant evils. Monetary stabilisation is in any case a necessary condition of the effective working of a competitivist system.

4. It cannot be maintained that even with a wisely managed monetary policy there can be no depressions or unemployment. Changes and especially discontinuities in conditions, physical, political or social, may result in a part, possibly a great part, of the economic capacities of the community finding no opportunity of remunerative activity. However great the dislocation, it is desirable that the trouble at any rate should not be aggravated by an unnecessary contraction of the flow of money. But when a part of the community's productive resources can no longer be usefully employed, a flow of money *in excess* of that which will keep its reduced capacity in a state of full activity will merely mean a depreciation of the monetary unit in terms of goods and services. A slight excess may be justifiable, in order to hasten the absorption of the displaced labour into new lines of production, but only within quite narrow limits.

The devastating effect of unemployment is due not only to the direct impoverishment which it inflicts, but also to the victims' sense of wasted capacities. The impoverishment can be alleviated by unemployment pay or by relief works. But relief works do not remove the sense of

waste, unless those employed on them can be deceived into thinking their work useful.

Special unemployment may be a cause of great misery and loss, but it is not such a baffling problem as general unemployment. The appropriate treatment for it is at any rate easy to understand. The people whose means of livelihood have disappeared, because the demand for the services they have been qualified to render has dried up, must be made capable of rendering some different services which the community needs and will pay for.

If the State is to intervene, it can provide advice and training, can establish agencies for notifying a demand for labour where it exists, can stimulate enterprise in new directions by various expedients, and can provide the means of support, temporarily for those who are in course of finding new occupations, perhaps permanently for those unfortunates who fail to qualify for any.

It is not surprising that those who are responsible for administering monetary policy (usually governors and directors of central banks) are extremely unwilling to assume the responsibility of a policy of stabilisation. It calls for a vigilance, a nicety of judgment and a delicacy of touch which fallible humanity cannot be sure of exercising. The power of deflation has to be used to prevent profits from becoming excessive. But that demands from the monetary authority a decision on the very thing that has baffled wage-earners and employers and wage tribunals. The only criterion to be appealed to is that profits be sufficient and not more than sufficient to afford a stimulus to enterprise.

A central bank or other monetary authority, however, is in reality much better placed than those concerned in the wage problems of a particular industry to judge of the matter. For they can disregard the inequalities of profits and the multifarious disturbing causes to which those inequalities are due, and can view the state of economic activity as a whole.

But, it may be asked, can a system be based on anything so indefinite and so subject to manipulation as the rate of profit needed as a stimulus to enterprise? Cannot the profit-makers themselves go on strike, and exact a higher rate of profit by a concerted refusal to undertake enterprise except on their own terms? The answer is that it is in any case open to them to do this, and there is no greater inducement when money is stabilised by reference to normal profits than under any other competitivist conditions.

In existing conditions profit is maintained by tacit accord among the profit-makers, and a stabilising monetary policy would do nothing to weaken the potential competition of new-comers, by which profit margins are subjected to a limit. Opportunities exist for concerted action among traders, securing them the practical monopoly of an industry, and those opportunities would be neither more numerous

nor more lucrative. Combined action among all the profit-makers throughout industry to secure monopoly profits for themselves is too far-fetched a supposition to deserve consideration. If it occurred, it would indeed be subversive, but the adoption of normal profits as a basis of monetary policy would neither facilitate it nor encourage it.

In fact, so long as competitivism is in operation, and profit-making is the motive of enterprise, normal profit, with all its vagaries and anomalies, can nevertheless supply a standard. Normal profit does not have to be either defined or ascertained ; what has to be acted on is not any statistical calculation of prices or of profits (though a price index can furnish an auxiliary criterion) but the evidence the banker receives in the course of his daily business of an unwonted acceleration of economic activity and enterprise. A central bank should be in sufficiently intimate relations with the commercial banks to have the full benefit of this evidence. So long as this treatment is successfully applied, and the brake promptly put on when excessive activity is developing, and as promptly taken off when the tendency has subsided, the conditions calling for a general rise of wages will not appear. The stability of wages will itself supply the real standard for the stability of everything else.

5. Such a policy would still be precarious if it were not understood by organised labour. It might be disturbed by a chance rise in the cost of living due to scarcity of some staple products, or a general rise of wages might be pressed for in a mistaken belief that the wage-earners can be benefited by having more money even if there is no increase in the supply of goods.

Ever since the outburst of inflation during and after the war of 1914–18 there has been a deep-rooted suspicion and reprobation of profit-making. The fact that the 'profiteering' of that period was the inevitable result of inflationary finance was never grasped by the multitude. When the flow of money through consumers' income, general demand and disposals exceeds the supply of goods, stocks of goods (outside the field of rationing) can only be defended against depletion by a rise of prices. The high prices (and the resulting high profits) are thrust upon the traders, and fulfil a function which is of great importance to the community. The high prices resulting from inflation are a parody of the normal working of competitivism, but that normal working does rely on high prices and high profits to remedy scarcity. *Some* profiteering is a normal incident of profit-making.

Yet to extort high prices on account not of high costs but simply of scarcity seemed a mean and discreditable proceeding. Public opinion has adhered to its condemnation of profiteering, and has not been able very consistently to discriminate between profiteering and innocent profit-making. A hostility to all profit-making is dis-

cernible. Pushed to its logical conclusion, that means hostility to the competitivist system itself.

In the present war the desire to 'take the profit out of war' led in Great Britain to the 100 per cent. excess profits tax which was imposed in 1940. That tax allowed what may be assumed to be a normal profit, either the profit of a pre-war year or a standard percentage of capital, and took the whole excess. In the case of any firm or company which was earning an excess profit, all immediate pecuniary motive for any further enterprise or activity or for taking any risk was destroyed, and in 1941 the tax was so far modified that one-fifth of the excess profits taken was to be treated not as a tax but as a forced loan, to be repaid after the war, with the idea that the money would then be used for refitting industry for its peace-time functions.

The 100 per cent. excess profits tax had the dangerous effect of removing for its duration all immediate pecuniary motive for resisting demands for higher wages. On the other hand it opened up a different point of view to organised labour. If the profits of an industry so expanded as to permit of a rise of wages, the increased cost would no longer fall on the employer, who would have had a surplus of funds to meet it from, but on the State at a time when its financial resources were being stretched to the limit. The trade union leaders and the mass of workpeople alike were willing to accept burdens and restrictions, but their willingness would have been substantially less if they had believed that wealthy people were being let off too lightly, and especially if profit-making traders and shareholders were gaining more in increased profits than they were paying in increased taxes.

But the hostility to profit-making is by no means limited to wartime profits. There is a persistent undercurrent of condemnation, which finds expression sometimes in labour disputes, sometimes in demands for ever more liberal social services and more severely graduated taxes, but at no point accepts a limit. Logically the rejection of profit-making leads inevitably to collectivism, and so long as that is not realised, competitivism is left in an equivocal position, with the incentive on which it relies for economic activity and enterprise discredited and sapped on all sides. At the same time it would not be true to say that competitivism has broken down or has been proved to be unworkable. That the economic history of the twenty inter-war years was disastrous is only too true. But that was due above all to the pitiful ineptitude of monetary policy. Given a systematic observance of a policy of monetary stability, the smooth working of the system ought to be attainable. Only on that condition will it be possible to envisage its other disorders and to devise remedies for them.

6. The hostility to profit-making has sometimes taken the shape of an alienation of workpeople from the classes of society that have

opportunities and responsibilities from which they themselves are debarred. The tradition of a governing class dies hard. A century ago it was still taken for granted among all except extreme radicals that political power ought to be confined to people of a certain social standing and education, and in practice the test was the possession of sufficient means. Profit-making was superseding property-owning as the principal source of wealth, and a governing class of the burgessry was superseding that of the gentry.

The governing class, whether composed of property owners or of profit-makers, was apt to identify the nation with itself, and in the manner of Nietzsche's superman to regard the 'lower orders' as helots, whose duty was to obey, to show proper respect and to ask no questions. The emergence of democracy and of organised labour went far to correct that. At the same time wealth and education and habits of responsibility carried weight even in a democracy, and people with these advantages inevitably retained the primary share in the immediate direction of public affairs.

An intransigent party which refuses to take the responsibility of working existing institutions is an anomaly in a democracy. So long as a country is governed by a ruling class, whether by an oligarchy or by an autocracy with its entourage, intransigents and malcontents are excluded from power and repressed. But a democracy which aspires to give all classes a share of power may be exposed to a wrecking policy on the part of a dissident faction.

Racial minorities have afforded many examples of that. The British Parliament suffered grievously from the presence of an Irish party which dissociated itself from all issues but those of Ireland. They could bring a solid vote in support of either of the principal parties, and might from time to time decide issues, vital to the country as a whole, in which they themselves ostentatiously refused to take any interest. There were many cases of racial minorities which impeded and deflected the action of European parliaments, though not quite so effectively as the Irish Nationalists.

The extremists of the Communist Manifesto are impossibilitarians, and communist parties avow themselves to be wrecking parties. A substantial communist minority in a democratic country, represented in an elective legislature by an intransigent party, may make its institutions unworkable. It can use its voting power as a make-weight to introduce mischief into every controversial measure which divides the other parties closely. Continental parliaments have suffered more than that of the United Kingdom from communist parties. But there have always been extremist groups with a propensity to intransigence in the Labour Party. Their influence has been felt not only in the big labour disputes but in the party's attitude to many questions of legislation or administration.

When a coal or transport strike is disastrously interrupting economic life, and the strikers assume that the loss and distress caused are the affair of the Government and not of themselves, they are disavowing a responsibility which attaches as much to them as to other members of the nation. When labour parties or socialist parties press for additional social services or for concessions to the legal position of organised labour, they are apt to shut their eyes to administrative complications, legal anomalies, economic repercussions and fiscal burdens. The implication is that, if the apparatus which the burgessry have devised to preserve their profit-making is exposed to damage, the remedies and safeguards are their affair.

This attitude is not wholly without justification. Let-do, with its industrial feudalism, does put the profit-makers in a privileged position which they may be tempted to exploit. Profit-making is one way of fulfilling certain purposes which are vital to the community. It supplies the remuneration and motive of enterprise, it is one of the principal sources of accumulation, and it is also one of the principal sources of tax revenue and therefore of the means of providing not only the modest outlay of the essential machinery of Government but the cost both of armaments and of social services. The profit-making traders may be regarded as farming this great fund, like the *publicani* who farmed the taxes of a Roman province. According to the subsistence theory of wages assumed by Marx, the surplus represented the entire disposable resources of the community, for the wage-earner, receiving only a bare subsistence, could spare nothing. The Communist Manifesto preached a class war between the burgessry who controlled this fund and the proletariat who were excluded from it. If the profit-makers paid the cost of Government, it was their own Government, concerned above all in maintaining their privileges; if they paid the cost of organised force, the organised force defended them and conquered new profit-making opportunities for them; if they accumulated capital, the capital was their own property. Communists who viewed matters in this light would repudiate the traditional loyalty to the State, and substitute for it loyalty to their class, a loyalty which, like that of religion, transcended national boundaries.

Had the Communist Manifesto and the economics of *Das Kapital* accorded with the facts of human society, the class war might have made more headway than it did. The subsistence theory of wages was a fallacy. Competitivism yielded a wage level that might rise far above the subsistence level. The wage-earner found himself with a stake in the community, and with much to lose. And democracy gave him a share in government, and the power of gaining a part of the surplus for his class in the shape of social services.

Advocates of the class war hold that this is not enough. The proletariat have made progress in that they have compelled the

burgessry to pay ransom. But the anomalies and inequalities of profit-making, if a little toned down, still remain.

In Russia they got their way, and the great transition to collectivism was made. It was unfortunate that it was made at the end of a disastrous war, and was made by violence. And it is not to be inferred that it cannot be made in a more orderly and merciful manner. A communist party which insists on cutting its way by revolutionary methods through a sanguinary class war to its objective cannot expect the rest of the community to acquiesce.

In conditions of tranquillity and prosperity there is little to fear from openly revolutionary movements. As the experience of Germany in 1930 showed, it is at times of acute and uncontrollable distress that such movements gain sufficient support to be formidable. But political intransigence is a more insidious danger. Whole-hearted intransigence would be hardly distinguishable from revolutionism. Its appearance in the everyday political field is intermittent, a matter of moods. In the same people who at one time display an unexceptionable public spirit a certain combativeness will at another evoke a propensity to wrecking manœuvres and political mischief.

Nor is it confined to organised labour or to wage-earning workmen in general. Enthusiasts are often to be found in other classes and in other parties. When middle-class members of Parliament attack profit-making, that is sometimes (but not always) because the electors they represent include many wage-earning workpeople, whose views they are inclined to champion. So long as the dependence of the economic system upon profit-making is not understood, the attacks upon it seem to be harmless, while the anomalies which expose it to attack are apparent.

There is a danger of the foundations of the competitivist system being gradually corroded till the whole may slide into the morass. If its defects are really fatal, and another system can be put in its place, its demise may not be a matter for regret. But all who support policies which contribute to its collapse ought to do so with their eyes open to the consequences.

CHAPTER XVII

THE FUTURE OF INTERNATIONAL TRADE

1. If mankind succeeds in averting the continuous menace of total war and the concentration of economic effort upon organised force, and if the problem of money, profits, wages and unemployment is successfully solved within the limits of competitivism, there are still other insistent problems to be dealt with.

One of the most conspicuous is that of international trade. Competitivism leaves international trade to find its own equilibrium through the foreign exchange market, but the employment of gold or any other international standard has always imposed limitations on the free working of the market. As we saw in Chapter XV, a policy of monetary stabilisation would facilitate the working of an international standard and would eliminate or at any rate would greatly reduce the frequency and magnitude of market disturbances.

But we have to deal with a situation in which the world has become familiar with the expedients resorted to under the stress first of extreme and prolonged depression and then of devastating war. These expedients cannot be swept away in an instant.

The restrictions which have been placed on the foreign exchange markets and foreign trade have been directed to two ends, on the one hand to prevent an export of capital, on the other to maintain a balance of current transactions.

It is the former that involves a voluminous code of regulations prohibiting a wide range of minutely defined transactions, and a vast administration for exercising discretion in cases of which the circumstances have to be individually examined. That system is only required and only tolerated when there is a fear that distrust of the monetary unit may cause panic movements.

To maintain a balance in current transactions, the restrictions take the form of a quantitative limitation of imports, which can be enforced without any interference with the foreign exchange market. Payment through that market can be permitted for all permitted imports. Restrictions on payment (applied to all payments to foreigners whether in foreign exchange or not) can be used as an administrative measure to enforce the restrictions on imports, but that is only a matter of machinery. It may be either the primary means of enforcement or an additional check to prevent evasion.

The restriction of imports places on the administrative authorities the responsibility of deciding how much of each commodity shall be imported. They can indeed disavow this responsibility and confine themselves to granting permission to any applicant to pay for any

imports till the total allowed attains a prescribed weekly or monthly limit, and completely stopping such payments when the limit is reached. But a more vexatious method could hardly be devised than one which gives the privilege of importing to the first comers in each period, and stops the business of the others without regard either to the needs or claims of the traders concerned or to the interests of industry or of consumers.

If import restriction is not to cause an intolerable dislocation of business, the administrative authorities must adopt some principle of allocation of the right to import among applicants. When it is held to be vital to reduce imports to a minimum, as in time of war or of monetary crisis, the singleness of aim facilitates the task. The community has to reconcile itself to privations and traders have to put up with inequality of treatment. In time of war these conditions may be prolonged. The privations and embarrassments are a part of the cost of the war. The paramount position assumed by the Government in the economic life of the country can be applied to remove or alleviate some of the inequalities and anomalies.

But if import restrictions are to be prolonged into peace conditions, and maintained when there is neither war nor monetary crisis, the question of a principle of allocation becomes fundamental. Competitivism invites the consumers themselves to determine the amount and character of imports. All the operations of traders are governed ultimately by the prospect of selling their products, and the prospect of selling is estimated (subject to some deviation on speculative grounds) from actual sales. As fast as goods are sold, orders are given to producers for supplies to replace them. When orders for any product exceed or fall short of productive capacity, prices are raised or lowered. This process regulates importation as well as production. If a system of import restriction is followed when in other respects competitivism is the rule, it is possible to allow the same forces to operate, and to admit imports corresponding to actual demand. But in practice that means giving permission whenever it is asked; it reduces the restriction to a formality.

If restriction is needed at all, it is needed for the sake of some operative effect. Regarded as a monetary measure, import restriction aims at maintaining unvarying rates of foreign exchange without resorting to monetary expansions or contractions to correct any disequilibrium that may arise. But it is at the same time a means of discriminating, like a protective tariff, in favour of home producers against foreign competitors.

If a policy of monetary stabilisation is adopted, expansions and contractions are in any case excluded. If that policy is pursued in isolation, and the monetary units of other countries are left to fluctuate, then disequilibrium will be corrected by changes in rates of exchange.

An international policy of stabilisation based on fixed rates of exchange will leave temporary dislocations due to fortuitous changes in productivity to be coped with. But a transitory adverse balance can be met by drawing on reserves of gold or foreign exchange, while a permanent loss of exporting power is better dealt with by a departure from the policy of fixed rates of exchange to the extent of an appropriate devaluation. A transitory adverse balance which exhausts the reserve may threaten the currency unit with a disproportionate drop in its value in terms of foreign exchange, and exchange control accompanied by restriction of imports may be the only remedy. But that is the case of a temporary crisis, which we are excluding by hypothesis.

A state of affairs is conceivable in which the foreign exchange market cannot of itself bring about a balance between imports and exports. There may be a loss of exporting power so severe that no depreciation of the rate of exchange can regain equilibrium. Depreciation raises the cost of imports to the home consumer, and gives a competitive advantage to the exporter, but it also tends to reduce the proceeds of a given volume of exports. Exporters can, it is true, get the benefit of world prices, but if the depreciation is to enable them to extend their sales, that will be to some extent by price-cutting and it may be that the loss on the low prices more than wipes out the gain in sales. Summary measures for the exclusion of imports may be the best way out.

Import duties are an alternative. Duties on things that can be produced at home have a protective effect and may be made prohibitive, at the cost possibly of inflicting inferior products and exorbitant prices on the consumers. A prohibitive duty is merely complete exclusion of the imports under another name, but import duties have an advantage over exclusion in that, if they are only just prohibitive, there is a potentiality of foreign competition which puts a limit to the exploitation of the consumer by the home producer.

In the case of imports of products of which there is no home supply, there should theoretically be some rate of import duty which would attain any desired quantitative limitation. The desired limitation, if imposed directly, diminishes supplies, and, in a given state of demand, the price rises till sales are correspondingly reduced. An import duty just equivalent to the rise of price should have the same effect on demand, and traders would then of themselves reduce their imports to the same extent.

The effect, however, of an import duty on demand is only ascertained by the method of trial and error, and a country which cannot find the means of paying for an excess of imports cannot afford to risk errors which may take that form. Yet even in that case experience should soon show what price is just sufficiently deterrent, and what duty therefore will ensure the desired diminution of imports. Even when

the diminution is effected directly by quantitative limitation, it is hardly defensible to leave the profits derived from the resulting high prices in the hands of the traders who are lucky enough to obtain the right to import. If a licence fee is charged equivalent to the price difference, that does not differ very greatly from a duty.

2. In certain circumstances quantitative limitation does present advantages in comparison with import duties. A licence fee is more elastic than a duty. Power can hardly be given to an administrative authority to vary a duty at its discretion. But the power to vary a licence fee can be given under the limitations consequent upon a system of quantitative restriction of imports, the extent of the quantitative restriction at any time being governed by the state of the foreign exchanges or other considerations of policy defined by legislation, and the amount of the fee depending on the resulting price difference.

For a country depending on a very variable exporting power (for example, where the principal exports consist of natural products subject to the hazards of crops) an administratively adjustable restriction of imports may have great advantages. A temporary failure of exporting power may approximate to a foreign exchange crisis. To keep control, a big foreign exchange reserve is needed. If the reserve is not big enough, and the currency unit is left without any support in the foreign exchange market, a restriction of imports may be the only means of averting a catastrophic depreciation.

The quantitative limitation of imports, being a readily adaptable device, capable of prompt application to a foreign exchange emergency, has attractions for any economically weak country. It would not be safe to assume that it will not be practised after the war. And if a few countries practise it, others are tempted and almost driven to follow their example. As we saw above (pp. 128–9), any two countries which regulate their foreign trade by quantitative limitation of imports are in a position to give one another preferences at the expense of those which refrain from the practice.

Suppose then that quantitative limitation of imports spreads, and becomes a general perhaps a universal practice. How will it work? What will be the effect on competitivism?

For the support of the foreign exchange value of the currency unit, what matters is the restriction of the *total* value of imports. But the effect on the community, that is to say, on traders and consumers, depends on how the restriction is applied to *each separate commodity*.

When it is applied to a non-competitive product, of which there is no home supply at all, the effect of a restriction of imports (in so far as it is not a temporary interference so slight as to be absorbed in stocks) is to reduce consumption. In the particular case of an important staple the restriction may be effected by way of rationing. Even where there is no rationing, there may yet be price control, and

if the controlled price is below that at which demand and supply would balance, a depletion of stocks will result, and some consumers will have to go without the goods. If the vexatious system of shop shortages is to be avoided, the price must be allowed to rise to the level at which demand is kept in check.

The course to be adopted in the case of each imported product is a matter of policy. Even for a non-competitive product it may not be exclusively a question of the consumers' interests or welfare. The product imported may be a material used in industry. Restrictions will then affect not only the consumer of the finished product, but also the manufacturers. A restriction of imports will involve the productive resources of the manufacturers, both plant and labour, in under-employment.

Then there are the competitive imports. A restriction of imports of a commodity of which there is a home supply discriminates, like a protective import duty, in favour of the home producer, and attracts productive resources into the industry. That is all right up to the limit at which the stimulation of the industry is just what policy requires. But beyond that limit it is laying up trouble, for when the restriction of imports is relaxed the industry will find itself encumbered with excess capacity, and with plant and labour under-employed. Indeed, even when the limit has not been passed, a relaxation of the import restriction may nevertheless be applied, and will have that result.

Thus the adaptability of import restrictions, which seems at first sight to be such an advantage, is a cause of instability in the industries affected, by introducing unforeseen variations either into their supplies of materials or into the degree of protection they enjoy. These variations are a serious drawback. The calculations and prospects on which enterprise is based are liable to be arbitrarily upset, profit may be turned into loss, capital outlay may prove fruitless, workpeople may be involved in unemployment.

Protection of home industries against the competition of imports is a policy which requires a certain compromise between the interests of traders and consumers. If a home industry needs protection, that means that it cannot serve the consumer as well as its foreign competitors; it needs an advantage in price to offset either higher cost of production or inferior quality of the product or both. Policy may be held to justify this, either because the industry, once started, is expected to grow more efficient and eventually to give good service, or because the industry already exists and loss will be inflicted if it is reduced or destroyed by foreign competition, or because a diversification of industry is desired even at some cost in terms of wealth, or because home production is thought necessary in case of war. Whatever the purpose, whether one of these or some other, policy warrants such restriction of imports as is necessary to accomplish it and no more,

As soon as any further restriction is imposed, the question of the interests of the consumer intrudes and demands consideration. The extent of the restriction of imports is determined by what is necessary to support the rates of foreign exchange, and the problem of allocating the total to be admitted among the different commodities remains.

When import restriction is no more than an expedient for meeting a temporary emergency, a rough and ready solution, such as allocation in proportion to the actual imports of each commodity in a selected past period, serves well enough. But that will not do as a permanency. Changes of circumstances will constantly call for revision of the proportions.

The function so placed on the Government is a noteworthy step in the direction of collectivism. The Government has to decide on the merits of different kinds of consumption. That is distinguishable not only from Government enterprise in public utilities undertaken to prevent the abuse of local monopolies, but even from socialistic services in such matters as education, health and housing. These latter are directed to some positive purpose, where the effective demand exercised by the consumer fails to evoke adequate provision for some need the satisfaction of which is held to be desirable in the interests of the community. Deterrent taxation may be imposed on forms of consumption which are regarded as deleterious and prone to excess. But what we are now considering is a branch of economic organisation which invokes the Government as arbiter among different kinds of consumption as to which it has no claim to see further or to judge better than the individual consumer.

In time of war, when imports other than those serving the purposes of war have to be ruthlessly cut down to a minimum, the Government has a clear principle for its guidance. Any imports that do not conduce to the efficiency of the community in its war effort must be excluded. The exclusion of unnecessary imports is one aspect of the curtailment of consumption as a whole, of which another is the diversion of home production wherever possible from the satisfaction of civilian demands to the war effort or to export.

In time of peace no such simple solution of the problem is available. There is no longer a single aim by reference to which all priorities can be settled. There are millions of individuals to whose welfare economic activity can contribute in infinitely diverse ways. In time of war it might seem enough to concentrate on the essential utility products, and let the creative products wait. But even in time of war human nature needs something more than utility products; a war effort so unremitting as to allow no time for leisure or recreation is likely not only to impair efficiency, but to undermine the fortitude and tenacity of the civil population, and leisure is mere tedium without some means of occupying it. Apart from the special stress of war, only conditions of dire

impoverishment would require priority to be given to utility products. In general import restriction would have to aim at holding a reasonable balance not only between utility products and creative products but between any one product or group of products and any other.

In practice only a rough and ready solution is attempted. Under an economic system that remains fundamentally competitive the natural criterion to apply is that of price. As soon as the price of any imported product rises to what appears to be an excessive level, the quota allotted to that product can be increased. But if the test is price, the regulation through quantitative limitation becomes an unnecessary complication; the desired result can be secured directly by the imposition of import duties corresponding to whatever excess over world prices may be aimed at. If greater elasticity is required than import duties enacted by the legislature are susceptible of, they may be called licence fees and varied by administrative discretion.

This administrative discretion is regarded as a great convenience, but its advantages are in reality extremely dubious. The reason why it is the general practice to impose import duties only by definitive legislation, and not to allow administrative discretion, is that it is important for traders to know how they stand, and not to be exposed to frequent and arbitrary changes in the conditions under which they operate. The objections to such changes are in no degree diminished by calling the duties licence fees.

Industry abhors discontinuities. To a gradual change in conditions it can adapt itself, and most of the changes arising from technological progress and the development of resources are gradual. If occasionally these are so rapid as to outstrip the adaptation of economic activity, and to approximate to the discontinuous, that cannot be helped. But to introduce into economic conditions the man-made discontinuities resulting from changes in import restrictions and duties is a wanton addition to the troubles of industry.

3. A country which relies on continual variations in its measures for restricting imports to regulate its foreign exchanges involves in these troubles not only its own traders but also those in the countries with which it trades. That is an additional motive for inducing the countries concerned to conclude clearing agreements with one another. But the clearing agreements then limit the discretion which was found so attractive.

But that does not mean that the trade is freed from the threat of discontinuities. For the clearing agreements themselves become a source of discontinuities. We saw above that the practice of quantitative restriction accompanied by clearing agreements nullifies the most-favoured-nation clause. The most-favoured-nation clause gained favour at the time of the reaction towards protection in the latter part of the nineteenth century, because it furnished the means of avoiding

the instability to which trade was exposed by unregulated tariff preferences between one country and another.

The discontinuities to which an industry is exposed, when a country to which it exports its products begins to discriminate by means of protective import duties in favour of the home producer, or to increase an existing discrimination, are bad enough. But time is probably needed to extend the capacity of the protected industry. When the discrimination is not in favour of a weak or nascent home industry but of a powerful rival exporting industry in a third country, the blow is much more serious. That is particularly so at a time of general trade depression when industry is under-employed, so that an industry which receives a tariff preference can take advantage of it without having to extend its existing capacity. And it is precisely at times of general depression and under-employment that countries are tempted to impose or to increase protective tariffs.

Suppose, for example, that the demand for a product in world markets as a whole declines 20 per cent., and two exporting countries, normally producing equal amounts, both suffer a reduction of sales in that proportion. Then if an importing country which is in a position to buy 20 per cent. of the normal output of each (that is to say, 25 per cent. of the reduced output) allows so substantial a preference to one of them as to exclude imports from the other altogether, the favoured exporters find themselves fully employed, and those in the other country find their under-employment increased from 20 to 40 per cent. If business revives, and the demand for the product returns to normal, then, unless the preference is terminated, it is very probable that the favoured exporters will extend their capacity so as to supply additional output for their sheltered market, and their competitors will remain under-employed.

At a time of depression, too, a new or increased measure of protection to home industries will enable them to use their unemployed capacity to displace foreign competitors in the home market, and is more damaging to these latter than when time must be given to the home industry to enlarge its capacity.

Thus a time of general depression, when nations are most tempted to adopt protective measures, whether by import duties or by quantitative limitation, is just the time when they inflict the greatest injury on foreign competitors.

Much of present-day economic theory has been evolved from the pathological state of industry in the ten years preceding the present war. International trade was reduced to a state of chaos, in which every country was inflicting on every other the distresses arising from violent discontinuities in the operation of markets. The effects of the depression were in some degree alleviated in the protected industries, only to be aggravated in the exporting industries. Those countries

which imposed exchange control and import restrictions relieved one another's exporters by means of bilateral clearing agreements, but the concentrated agonies of exporters who were excluded were all the more severe.

And the whole system was inherently insecure. An agreement depending on specified quotas of the commodities to be imported inevitably came up for reconsideration at short intervals, and every renewal was an opportunity for countries to bid against one another. Every agreement inflicted loss in some directions, and those countries which suffered the loss were eager to offer concessions in exchange for modifications in their favour, or alternatively to threaten retaliation. The trader who found a favourable market in the quotas secured by his country's negotiators could not count on his advantages lasting for more than a few months.

The insecurity was inherent because import quotas could not be so planned and defined as to adapt themselves automatically to changing conditions. Import duties, it is true, may need to be changed. Protected industries press for higher duties, or exploited consumers press for lower. But they need not *necessarily* be altered. If it has been decided that a certain duty will afford precisely the degree of protection desired, trade and industry will adapt themselves to the duty as it is, and even if it does not turn out to be quite what was expected, it is likely to be given a trial, at any rate, of some years. But a limitation of the imports of a product to a prescribed quantity requires to be modified in the light of every variation of demand or of productive capacity.

The results of the general resort to exchange controls and import restrictions have been disastrous. The decline of international trade has figured almost as prominently as unemployment in accusations of failure made against existing economic institutions. In Chapter IX (pp. 156–7) we saw how technological progress has increased the mutual dependence of economic interests, and how frontiers may intervene across the flow of natural products from the land to the manufacturer, of intermediate products from one manufacturer to another, or of finished products from the manufacturer to the consumer. And there are industrial and urban concentrations which draw their supplies of foodstuffs from far afield. In such cases foreign trade is vital. Where there are climatic differences—for example, in the supply of tropical products to countries in the temperate zones—foreign trade provides benefits not otherwise obtainable. And there is a huge volume of international trade which, while in no way indispensable, contributes substantially to the welfare of mankind.

Interference with these activities causes loss and possibly impoverishment. But it does not involve anything approaching a breakdown of the economic system so long as the interference itself is not subject to *change*. If the economic life of the world had developed

without any international trade at all, mankind would have been fewer and poorer, but that would not have prevented economic institutions from working smoothly within the limits and resources of each self-contained community. The economic life of the Earth does not break down for want of trade with Mars.

An exaggerated importance is often attributed to international trade. It is a source of profit-making, and yields wealth in a form especially conducive to national power, and it offers a tempting field for measures of economic nationalism. The opposition evoked against such measures is apt to over-estimate the importance of the international trade which they diminish.

But the liability to change, especially to discontinuities which inflict a paralysing insecurity on the industries dependent on foreign trade, is a much more serious matter than the actual curtailment of the amount of trade. Population and productive resources settle in a place where they can prosper so long as they have access to supplies of food and materials and to markets for the sale of their products. If they are cut off from either, they may be faced with ruin.

Protective import duties, being a form of Government interference with the free course of industry, are a departure from let-do. But they are not in any essential way inconsistent with competitivism. In the modified environment which they create, the profit-making motive works normally.

Quantitative restriction is a much more considerable departure. It requires continual administrative decisions on matters of demand and supply, which competitivism would leave to the traders who work the markets. As we have seen, the harm inflicted consists not merely in the diminution of the volume of international trade directly caused by the obstructions which the import quotas impose, but still more in the traders' paralysing sense of insecurity.

The combination of foreign exchange control and import restrictions can be used, as it was in Germany, to enforce a regimentation of industry on collectivist lines, without ostensibly establishing collectivism. That was a device which was quite suitable as a part of the totalitarian system for concentrating on rearmament and the preparation for war. But it is hardly defensible as a permanent institution. A community that desires regimentation of industry can have it, but may as well have it applied systematically. There is nothing to be said for confining regimentation to those industries which happen to be concerned in international trade, in that they export their products, or use imported materials, or are in competition with imports. If the interference with foreign trade is to go beyond what the exigencies of foreign trade itself require, and to supply sanctions for enforcing regulations relating to traders' activities in general, the partial applicability of the sanctions involves unfairness.

4. If import restrictions and exchange control have been the result of monetary instability and deflation, then a necessary condition of avoiding them will be monetary stabilisation. In any case monetary stabilisation is an indispensable condition of the survival of the competitive economic system. A failure to prevent the recurrence of deflation and depression can only lead once again to desperate discontent and uncontrollable political convulsions.

Given a successful measure of monetary stabilisation, it is to be hoped that statesmanship will make a stand against the continuance of restrictions. But, as we saw in Chapter XV, the end of the war is bound to be followed by a dangerous interval in which monetary systems will be threatened by the accumulation of loose money resulting from the financial strain and the war-time restrictions on consumption. Monetary stabilisation cannot begin in any country till that stage has been surmounted. Probably during the interval, when measures are being taken (for instance, by forced loans) to extinguish the redundant money, the continuance of foreign exchange control will be unavoidable.

But somehow or other the dangerous interval will be passed through, even though in some countries it be only after the ordeal of a monetary collapse. And when that critical phase recedes into the past, there is the opportunity of establishing a monetary system which is not dependent on controls and restrictions.

What is needed is the selection of a foreign exchange value of the currency unit, which will be consistent with equilibrium in current transactions. Exchange control is a device for defending a weak currency, and a weak currency is an over-valued currency, one that makes the world price of imports too attractive at home and the home price of exports not attractive enough abroad. That is the state of things which involves the currency in discredit; if it is not remedied, the excess of imports exhausts the reserves of foreign exchange or gold, and then, if not sooner, the currency unit depreciates. When people realise that the existing rates of exchange are untenable, they hasten to divest themselves of holdings of the discredited currency and of securities denominated in it, and to acquire assets abroad instead.

That is how the most serious adverse capital movements originate. It is the disequilibrium of *current* transactions that makes the rates of exchange untenable. Disequilibrium may, it is true, also originate in a heavy external liability, such as the Reparations and War Debts which troubled the world after the war of 1914–18. If such an exceptional liability exceeds the available reserves, it cannot for the time being be met. Given time, the balance of current transactions may be capable of absorbing the liability. But that means a diminution of imports and an expansion of exports. So here too the disequilibrium of current transactions is the root of the matter. A liability that

cannot ultimately be met by such an adjustment cannot be met at all.

It is a mistake to approach the problems of foreign exchange from the point of view of capital movements. So regarded they are insoluble. Whatever may be done, it is always *possible* for an onrush of demand for foreign exchange to break down the market. It is undoubtedly desirable to take precautions against such an onrush, to hold big reserves, and possibly to arrive at agreements with foreign central banks for temporary advances in case of emergencies. But no precautions will avail against an underlying disequilibrium of current transactions. Unless it is corrected, there will be an ever-growing external indebtedness, which will eventually exhaust the reserves and the borrowing powers of the debtor countries.

A country which has been troubled with a weak currency may be tempted to continue exchange control as a precaution into the period of stabilisation. But that that will be necessary is not to be taken for granted. Experience has shown over and over again that a country which has suffered from inflation, and has stabilised its monetary unit at rates of exchange approximating to those prevailing in the market, finds itself extremely *short of currency*. That is to say, the total wealth value of the monetary circulation at the level so determined is far less than the total wealth value of the balances of money that people need to hold for the transactions of their ordinary life and business. This shortage of currency supplies an invaluable support to the monetary authorities in their task of maintaining the prescribed value of the unit. They can refuse to create additional currency except by way of purchase of foreign exchange, and they will thus find themselves intervening in the market not to keep the value of their own unit up, but to keep it *down*, and in the process of doing so they will accumulate a reserve of foreign exchange.

5. A proposal designed to eliminate the discriminatory effect of exchange controls, and so to provide a middle course between control and a free market, is that of a multilateral clearing. Any participating country, instead of receiving payment in the currencies of those to which it exports or which are otherwise indebted to it, would receive a credit of the equivalent to the account of its central bank in the books of an international agency or exchange centre, and the central bank would pay the amount due in its own currency. The books of the exchange centre would be kept in a special unit, not to be identified with the monetary unit of any of the participating countries, and the exchange centre would offer to buy or sell money in any of them at fixed rates of exchange. Thus there would no longer be any difference between the proceeds of sale of exports to the several countries; sales would never be for weak currencies.

But that would be because the exchange centre would become the

creditor of all the countries with adverse balances. If all countries could be relied on to take prompt measures to rectify any adverse balance, the system might work smoothly. But the whole trouble arises from the difficulty of doing so.

The exchange centre might be the depository of the participating countries' gold reserves, so that it would hold a good asset as well as balances of weak currencies. But the debtor countries may exhaust their reserves. The exchange centre will inevitably be, not a mere clearing mechanism, but the lender of last resort in the international system of central banks.[1] It must have the power to refuse to lend to a debtor country, or to impose conditions.

Associated with adequate plans for stabilising monetary units, a multilateral clearing might be a valuable institution. So long as the principal participating countries are all maintaining a stable flow of money, an adverse balance experienced by any country will arise either from some economic misfortune or from a lapse into inflation, and the treatment accorded to it can be adapted to the circumstances. But if the principal participating countries themselves allow a deflation to occur, all the rest will be involved in difficulty and distress.

Multilateral clearing requires fixed rates of exchange. No country can *bind* itself to maintain fixed rates of exchange. That would impose a more dangerous rigidity than the gold standard itself. But given a general policy of stabilisation of the flow of money in all, there would rarely be need of altering any rate.

The borrowing facilities offered would be relied on to induce any country with a weak currency to abstain from measures of control and restriction. But the success in doing so depends on the willingness of countries in that position to borrow. They might prefer the relative independence of exchange control and import restrictions. Moreover borrowing is no better than a temporary palliative unless it is accompanied by remedial measures, and these will still be precisely those distasteful measures to avoid which controls and restrictions have been imposed.

In fact multilateral clearing only works under the conditions which favour the working of a gold standard. Given those conditions, it might be a useful piece of machinery. But if its purpose is to perpetuate the administrative apparatus of exchange control and import restrictions, its claims are suspect. And surely there are objections to maintaining that apparatus when it is not serving any purpose. If the central bank is to have a monopoly of dealing in foreign exchange, dealing without its permission must be made a criminal offence. The

[1] See my *Art of Central Banking*, section on an *International Central Bank*, pp. 273–8. An international lender, with its own monetary unit, would be a feature of Lord Keynes's *bancor* proposal. But that proposal is not essentially associated with the machinery of multilateral clearing.

law so constituting it cannot be effectively enforced without a postal censorship, and there are sure to be innumerable border-line cases of individuals and trading concerns with a footing in more than one country, for whom it is impossible to define the offence satisfactorily. Every foreign trader is a potential banker.

6. When France, the Netherlands and Switzerland, the only surviving gold standard countries adhering to the old parities in a free foreign exchange market, abandoned the gold standard in 1936, France, Great Britain and the United States concluded a Tripartite Agreement which was to regulate their monetary policy. The agreement was innocent of any plan for stabilising the wealth value of their monetary units or any of them. Indeed such a plan would have been only too obviously premature, for all three countries were still in the throes of severe under-employment, and urgently needed a further expansion of the flow of money and a rise of prices to recover normal activity. The leading preoccupation of those who concluded the agreement was a fear of competitive depreciation. This was a lamentably wrong-headed idea. When a general deflationary movement has caused conditions of depression and under-employment in a group of countries, all are in a state of precarious equilibrium depending on the continuance of depression and unemployment to prevent each from buying too much from the others. If a reduction of wages is impracticable, and a restriction of imports undesirable, the only way of escape is an expansion of the flow of money. But an expansion of the flow of money in one of the countries will not only stimulate activity among its own producers but will also attract additional imports. It will in fact disturb the equilibrium of current transactions, unless the currency unit is allowed to depreciate. Therefore by barring depreciation the Tripartite Agreement cut off the only practicable way of escape from depression.

Now by depreciation a country will gain relief partly at the expense of those others which compete with its exports, and will undeniably aggravate their troubles. But at the same time it will be taking additional imports, so that what its competitors lose those from whom it obtains imports gain. By reducing the foreign exchange value of its currency unit the country is not taking to itself any exceptional or unfair competitive advantage; it is merely regaining the position in which its external trade is normally active and normally remunerative. The depreciation does, it is true, raise the price of imports, but only so far as *partially* to correct the attraction of imports by the increased spending power of the people.

It is sometimes argued that the reduction of exporters' costs by depreciation of the currency is a too easy substitute for increased efficiency of production. No one would dispute the desirability of efficiency, and increased efficiency in the production of foreign trade

products enables a country to maintain equilibrium with more favourable rates of exchange. But increased efficiency at unchanged rates of exchange would have the same adverse effect on competitors as a depreciation of the currency unit, and if they also make equal progress in efficiency, there will be no gain in activity.

But in any case efficiency is not to be had for the asking. An economist who says that industry ought to be more efficient is as helpful as a doctor who says that people ought to be more healthy, or a politician who says they ought to be better off. The practical problem is to devise measures which will promote these ends, *human nature being what it is.*

The dread of competitive depreciation is traceable to the supposition that the advantages of depreciation accrue only to the exporting industries, and last only so long as the costs of competing exporters are not similarly reduced. That is a misconception. The advantages of depreciation accrue throughout the field of industry. Depreciation is an indispensable condition of an increased flow of money, since without it the increased spending power of the people would attract an excess of imports ; but it is also an active force, applying a direct stimulus not only to the exporting industries but to those which compete with imports, and these have favourable repercussions on the rest of economic activity. Once started, the movement towards activity gathers impetus, and, if no impediment intervenes, will only stop when full employment has been reached. Full employment sets a limit to the country's further competition both in export and in import markets.

The stimulus is not one that all countries can apply at the same time. It is available to one (or at most to a small number). All can, it is true, devalue their currency units at the same time in relation to gold. That might result in an expansion of the flow of money in terms of currency units in all, but it might fail to do so, resulting simply in a rise in the price of gold, all other prices remaining unchanged. The rise in the price of gold would permit a given quantity of gold held in reserve to support a greater superstructure of currency and bank credit, but the further step to an enlarged flow of money would depend on measures of credit relaxation. Those measures would not in any of the countries be reinforced by a change in rates of exchange raising the prices of foreign trade products in its markets, and they might fail.

If devaluation is not available as a concerted measure, any one country that resorts to it is rather apt to be frowned upon as stealing a march on the others. But the remedy is in their own hands. All they have to do is to devalue their own units. It is quite unnecessary to take precautions against their purpose being defeated through their all trying to do it at the same time. In the absence of concerted simultaneous measures (which would take much planning and negotiation) there are sure to be intervals between one country's devaluation

and another's. The intervals need not be long. A few weeks or even days should suffice to place foreign trade products on a new price level.

The fear of competitive depreciation only arises at a time of general under-employment. If at such a time a general and simultaneous monetary expansion can be induced, full employment can be recovered without disturbing existing rates of exchange. But if deflation has been allowed to get beyond control, so that a vicious circle of depression defies the ordinary methods of credit relaxation, the only way out may be to start revival in particular countries by allowing their currency units to depreciate.

The Tripartite Monetary Agreement of 1936, far from being a model for post-war international co-operation, represents a policy which is only likely to be operative at times when it can do nothing but harm.

CHAPTER XVIII

THE FUTURE OF ACCUMULATION

1. WHAT I have called competitivism is very commonly called capitalism. Capitalism in that usage means the private ownership of capital. The burgess feudalism which was attacked in the Communist Manifesto was founded on the private ownership of the capital equipment of industry, as the medieval feudalism which it had superseded was founded on the private ownership of territory. The power of appropriating the surplus, which was inveighed against in Marx's *Das Kapital*, appertains to the profit-maker in his capacity of employer of labour, but he holds his position as an employer because he is the owner of capital resources.

At the same time ownership of an enterprise means something more than the ownership of its capital equipment. The owner is a party to all the contractual relations of the enterprise, both with those employed in it and with those with whom it transacts business, and, outside actual contracts, he is the repository of the connexions constituting its goodwill, the willingness of people to have dealings with it. These things are the source of an employer's power and authority. All, however, are derived from the possession of the necessary material equipment. The prerequisite condition of creating a business is command of the resources required to equip it.

In Chapter VII we surveyed the mechanism by which the investment market directs the available accumulation into its destined use in industry, and equalises capital outlay on the one side with savings on the other. We then saw that the smooth working of this mechanism depends on the openings for prospectively remunerative capital outlay being sufficient to absorb savings, that is to say, to satisfy the demand for opportunities of accumulating wealth. For the time being we can assume that this condition is fulfilled. Civilisation cannot be said to have been within sight of an insufficiency of openings, even before the present war threw the business of capital maintenance and extension enormously into arrears.

Competitivism regulates the pace of accumulation, and therefore of the growth of the capital equipment of the community, by the action of the individuals who save. The total accumulated in any interval of time is the sum of the savings of individuals, and is entirely divorced from any direct consideration of what the interests of the community require. Not only may accumulation be greater or less than a centralised conception of policy would aim at, but it may fluctuate in a capricious and fortuitous manner.

A competitivist community, however, is not entirely without

the means of central direction. In the first place the fluctuations in savings are to a great extent the result of monetary conditions. Here once again we encounter the troubles caused by monetary instability. An increased flow of money, engendering full employment and high prices and profits, swells savings more than in proportion to incomes. A decreased flow of money, causing under-employment and low prices, reduces savings to a disproportionately low level, possibly even below zero. As we saw in Chapter VII, the fluctuations in capital outlay are not so violent as the fluctuations in savings, because depression causes an extensive liquidation of working capital. Nevertheless a condition of any considered policy in regard to accumulation is such a measure of monetary stabilisation as shall at any rate reduce these fluctuations within moderate limits. This is one more reason for regarding monetary stability as an indispensable condition of the working of a competitivist system.

Given the satisfaction of this condition, and the elimination of any big variations of accumulation arising from monetary fluctuations, in what ways can the rate of accumulation be influenced, and by what principles should such influence as can be exercised be guided?

Even in conditions of unqualified let-do, the action of the Government cannot be without influence on accumulation. Let-do in any form that can be practically contemplated cannot exclude a certain minimum of public enterprise involving capital outlays, and war and preparation for war are bound from time to time to necessitate large non-recurrent expenditure exceeding what can be met from revenue. The Government must raise funds from the investment market by the issue of loans, and, unless its indebtedness is to grow indefinitely, it must set up sinking funds to pay off the loans.

Whenever the Government raises funds from the investment market, it encroaches on the capital resources left for private enterprise. If the funds are used for the capital equipment of public enterprise, that is a form of accumulation, substituted for what private enterprise might have done. If they merely fill a deficit, the amount of accumulation is diminished.

A sinking fund constitutes an addition to the resources of the investment market, provided forcibly at the taxpayer's expense. If it represents no more than a reasonable allowance for the depreciation of the Government's capital assets, it is no net addition. Moreover, it may be provided by taxation in a form which diminishes the taxpayer's power or will to save.

There is no simple or certain way of computing the effects of Government finance on accumulation. Whether the Government is itself saving or overspending, and in either case by how much, can be estimated in the same way as for a commercial enterprise. But the reactions of taxation on saving are more difficult to estimate. What

savings would have been if taxation had been less, or had been different, is a matter of hypothesis.

Nevertheless these effects, however uncertain in magnitude, can be taken into consideration in the framing of financial measures. Nowadays the capital outlay of governmental authorities, central and local, on public utilities and other works has come to be a very substantial proportion of the entire capital outlay of the community, and huge war debts make sinking funds a large item. Capital outlay (*less* depreciation) met from revenue, *plus* sinking funds, constitute an additional saving imposed forcibly on the community, from which has to be deducted the conjectural amount by which the taxes imposed to raise the necessary revenue may be supposed to reduce saving.

The Government is in a position to enforce a large additional saving upon the community. To what extent will it be advisable to exercise this power? If, as is very usual, all considerable public works are paid for with borrowed money, and the sinking funds set up are calculated to provide the approximate equivalent of appropriate depreciation allowances, the issue becomes one of the sinking fund to be established for the dead-weight debt, that is to say, the debt which has been incurred to meet deficits, particularly the vast deficits of war finance, and represents no tangible assets.

2. Sinking fund policy is usually governed by considerations of the magnitude of the debt and the time within which it should be paid off if successive emergencies are not to raise the total burden in course of time to something in excess of what the fiscal system can bear. Calculations of that kind leave no place for the formulation of a *policy* in regard to accumulation.

In recent years much attention has been given to the influence of Government finance on accumulation, but with reference rather to the effects of accumulation on the flow of money than to the attainment of the most desirable rate of accumulation.

To the individual who saves, accumulation is the means of providing for the future, his own future and that of his family. The primary purpose is to guard against any future want of resources, and, after that danger has been provided for, he may aim at providing a permanent income for himself and his family, or at gaining the power that disposable wealth gives in economic enterprise or in other departments of human affairs. These are not matters in which public policy calls for much interference. The social services make a minimum provision for some of the contingencies which involve people in want, such as sickness, old age, unemployment, widowhood or orphanhood. But this provision does not supersede the need for individual savings. Accumulation of a large fortune has social reactions which may be regarded as undesirable. The power which great wealth in the hands of one man gives is open to abuse, especially in an economic

system which is founded on profit-making. And the endowment of a family is likewise open to abuse; if caught in the wrong tradition, it may breed generation after generation of idlers or vulgarians.

Large-scale accumulation is an accompaniment of profit-making; it tends to form a class or caste of profit-makers, maintaining their position as such with their inherited wealth, and at the same time using their wealth to secure all those advantages of culture, manners and habits which distinguish a superior class. Thus is engendered a plutocracy, aggravating the inequalities which are in any case incidental to profit-making. Whether wise spending or unwise spending makes the inequalities more galling it would be difficult to say.

The heavy and severely graduated direct taxation on incomes and property, which has grown up in the present century, not only diminishes the inequalities of wealth in relation to immediate spending power, but cuts deep into the accumulations of the rich. While graduated estate duties take a heavy toll on the transmission of wealth to a new generation, the high rates of taxation on big incomes cut off a great part of the means of accumulation at the source.

But fiscal measures calculated to diminish accumulation by the rich (which is always a substantial part of the total accumulation of the community) inevitably raise the question whether diminished accumulation is a detrimental result, and one which ought to be counteracted by compensating measures such as an increased sinking fund, or capital outlay on public enterprise defrayed from current revenue. These compensating measures require still further taxation, so devised as not to encroach appreciably on saving.

But on the other hand it may be held that a diminution of accumulation is innocuous or even desirable. What has to be decided is the desirable rate of progress in extending the material equipment of society, and particularly the instruments of production and consumption.

If all economic activity is conceived as dominated by the exigencies of war and armaments, that paramount purpose will settle the question of accumulation along with all the rest. But if welfare is to be the end, it is not easy to formulate a guiding principle.

3. Till recently it was taken for granted that accumulation could proceed fruitfully without any limit that need be taken into account. Every addition to the community's instruments of production would enrich the community by adding something to its output. As the more lucrative openings came to be filled, there would be a tendency for the yield of any given amount of capital outlay to diminish, and consequently for the rate of interest to fall. But against that tendency there would be the discovery of new instruments of production which might have a high yield.

The nineteenth century opened with the immeasurable field of

capital expansion presented by the mechanisation of industry and transport, and ever since then the hypothesis of unlimited opportunities of remunerative accumulation has been fulfilled. There have been intervals of stagnation, but they have been attributable not to satiety of capital expansion, but to conditions of temporary depression, when a set-back to the demand for consumable goods has been accompanied by a set-back to the demand for the capital equipment to be used in producing them. The long-term rate of interest has not been always a predominantly falling one. It has been low at times of depression, but was about as high in 1914 as at any time, except those of crisis or exceptional pressure, in the preceding hundred years.

Under these conditions accumulation constitutes a forgoing of some of the present advantages of consumption in favour of the future enrichment of the community. If the future enrichment is *permanent*, and there is no permanent disadvantage to set against it, it would appear at first sight to outweigh *any* temporary privation, so that the desirable accumulation would be the greatest consistent with no resulting permanent loss, a loss in which not only efficiency in production, but also the capacity for enjoyment of the products of industry and of the opportunities of human life generally has to be taken into account. The community can afford to be more far-seeing than the family, and can weigh the welfare of people living centuries hence against present welfare, without discounting the former except for uncertainty.

But, in making these calculations, it would be a fallacy to treat enrichment as measurable in units of exchange value, even if those units are assumed to be stabilised in terms of human effort. As a community grows richer, the advantage of each additional increment of wealth is likely to grow less. That is not certain at all stages, for increased opportunities of production and of leisure might open up new possibilities which a human race preoccupied with necessary daily work would never conceive. But, within the limits of what can reasonably be foreseen, the advantages of additional productive power may be expected to taper away in the course of a future of growing superfluity till satiety is approached and they become practically nothing. On that ground alone it would be wrong to inflict privation on the present for the sake of an indefinite superfluity in the future.

And on the side of production, if accumulation is devoted to increasing productive power, that is done by the installation of capital equipment, which the progress of invention may at any time render obsolete. The same unceasing technological progress which ensures a perpetual supply of favourable openings for new capital outlay makes the value of existing capital equipment, from the day it is installed, precarious.

Whenever new plant is installed, the calculation of the appropriate

depreciation allowance, and therefore of its share in the cost of the output to which it contributes, depends on an estimate of its life. If more resources are made available through the investment market for capital outlay, the process of installing additional material aids to production will be accelerated. That process, the 'deepening' of capital (above, p. 113), does not consist exclusively in supplementing existing plant with new labour-saving appliances, but often takes the form of superseding existing by improved appliances.

When that occurs, loss is inflicted on the owners of the existing appliances. The improved appliances are installed in the first instance in new concerns or concerns where those to be superseded are already worn out and due to be discarded. But if the improvement is important, its competition reduces the value in use of the old appliances, and they have to be discarded sooner than would have been necessary on account of mere wear. This contingency of early obsolescence and supersession by further improvements has to be allowed for in calculating the earning power of *new* improvements. Their estimated life is reduced when the contingency becomes more probable, the depreciation allowance is so much the greater, and the cost-saving capacity so much the less.

Therefore too lavish a provision for capital outlay may turn out to be wasteful. A provision which was intended to be additional accumulation may be largely eaten up by unforeseen depreciation. Alternatively the desire to preserve plant which has been installed at heavy cost may obstruct the introduction of improvements. And heavy commitments in fixed plant may get in the way of meeting changes in demand.

The deepening of capital, though it includes many improvements that supersede existing instruments of production, is primarily a substitution of instruments for labour in the productive process. And on this side also too rapid progress may cause loss. Labour-saving appliances have the drawback of displacing from employment workpeople who may possess specialised skill and aptitudes, and who cannot easily find other suitable employment. If the new appliances are introduced gradually, the transition is eased, and the specialised employment continues for a time for a diminishing residue of workpeople, as some retire from work, and others forsake what is seen to be an expiring employment in order to take work elsewhere. If the introduction of the new appliances is hastened, the process of finding employment for the displaced labour may fail to keep pace, and technological unemployment will result.

These drawbacks attendant on too great a rate of accumulation are a matter of degree. They do not point to a definitely most desirable rate of accumulation, but only to caution in adopting measures calculated to increase the rate. They do show that accumulation

cannot be unreservedly identified with a growth of wealth, still less with a growth of welfare.

The fiscal policy of the Government may reasonably aim at supplementing accumulation with a substantial sinking fund and with capital outlay from revenue, so long as the introduction of innovations is not causing any serious loss by the displacement of capital and labour. The very thing, a big unproductive national debt, which calls for a sinking fund is likely to have retarded the normal progress of capital outlay in course of being incurred, so that the additional accumulation generated by a sinking fund will for a time at any rate go towards overtaking arrears of capital outlay rather than giving an exceptional stimulus to innovations. If the debt has attained such a figure that financial prudence requires a sinking fund larger than is consistent with accumulation policy, a way out can be found by a capital levy. A capital levy, on such a scale that it makes a substantial impression on the swollen debt, and cannot be met out of the capital owners' incomes, achieves the reduction of the debt without putting additional resources in the investment market.

A capital levy and a sinking fund both differ from individual savings in that neither increases anyone's resources. The benefit they bring to the individual is the prospect of having to pay less taxation in the future. But as the result of a sinking fund a part of people's resources, previously represented by nothing but the Government's indebtedness, comes to be represented by tangible assets, the creation of which constitutes accumulation. In the case of the capital levy, which is presumably paid by a transfer or sale of securities, there is an actual reduction of the individual's resources.

4. In the matter of accumulation a country cannot be considered in isolation. The investment market is an international organ, capable of applying the savings of one country to the capital outlay of another. The savings accumulating in the great profit-making commercial and financial centres seek an outlet in the capital needs of industry and transport far afield. The situation of productive enterprise is determined, subject to facilities of transport and marketing, by physical conditions. Natural products have to be obtained in the places where the productive material, whether from the soil or from below the surface, is to be found. Population settles wherever the opportunities of productive activity exist. Transport is created to serve the needs of the productive activity and of the population.

The opportunities for capital outlay are spread wide over the surface of the world, and their local distribution differs greatly from that of the savings from which the capital outlay has to be met. Savings are therefore dispersed from the rich centres, as water is dispersed by an irrigation system. A centre will find a field of capital outlay within the boundaries of its own country, but there is no certainty that that

field will offer it the most attractive openings, or that other countries less favoured in the possession of profit-making centres will not offer more lucrative prospects.

To some extent indeed national frontiers do obstruct the flow of the irrigating stream of capital resources. Those who become the possessors of shares or proprietary rights in enterprises situated in foreign countries, or the creditors of foreign governments or other foreign debtors, expose themselves to risks from which investments at home are exempt. Their rights are at the mercy of foreign legislatures, and, even when the law is fair to them, they depend on the procedure and interpretations of foreign courts for the enforcement of their rights. The transfer of interest, dividends and capital repayments depends on the functioning of the foreign exchange market. And there is the risk of the foreign countries being involved in war.

Since 1914 all these risks have become greater. That did not prevent external investment from reviving on a considerable scale in the years 1920–30, and its decline thereafter was due as much to the shrinkage of investible resources under conditions of extreme depression in the financially strong countries as to increased caution. The depression itself, however, brought an evil crop of defaults and bankruptcies, which involved external investment in discredit, and at the same time political insecurity became acute.

When external investment is in vogue, any country, not an actual importer of capital, which increases its accumulation by way of amortisation of its national debt is likely to find the additional accumulation taking the form mainly of additional external investment. The acceleration of the deepening of capital and of the installation of improvements will be spread over the world, and will thus be spread thin.

External investment up to 1914 was largely for the exploitation of new territory. The capital outlay needed to equip territory which was ready for settlement with the means of transport and with public utilities was heavy. There was a period of large-scale emigration from Europe, and, wherever a stream of emigrants found a place of settlement, a clamant demand for capital resources arose, to equip the new community with the essential means of production, of habitation and of transport. So long as the flow of emigrants into the new community continued, an increment of capital would be needed corresponding to the increment of population, and exceeding the rate of growth corresponding to a natural increase.

Even among countries between which no emigration is occurring there are likely to be discrepancies between the supply of savings and the requirements of capital outlay, and a resulting flow of investment from those containing rich commercial and financial centres to those not so favoured. But when no country is experiencing more

than a natural rate of increase of population, this flow will be substantially less.

These considerations would seem to point to a diminished volume of international investment so long as immigration into the new countries is restricted. Moreover the former great importers of capital are becoming, as past accumulations bear fruit, themselves sources of accumulation. The United States was a great exporter of capital in the years of prosperity ending with 1929. In the British Empire the Dominions have nearly, if not quite, attained self-sufficiency in accumulation. After the present war those countries suffering from the most acute shortages will have to be assisted from the capital resources of those less distressed, but that will be a temporary phase.

On the other hand, it cannot be assumed that, once post-war exigencies have been met, international investment will become insignificant. The world contains vast populations, especially in Asia, suffering from what people of European stock regard as an extremely low standard of capital equipment, industrial plant, housing, public utilities and transport all being very inadequate. A territory already inhabited by a population in a state of need offers as big a field for desirable capital outlay as one which is in course of being settled by immigration.

A revival of international investment will depend not merely on the existence of needs, but on security. The international anarchy in the form in which it prevailed in the nineteenth century did not greatly discourage international investment. A great proportion of the external investment of the rich centres was, no doubt, in their colonies and dependencies where a common sovereignty reduced the political risks, but that was far from being the whole. The investment in countries of alien sovereignty was also very large. Investors were not deterred by the risk of war, even though in the nineteenth century the threat of war was very readily introduced into the parleys of diplomatists, because it was assumed that private rights, even if suspended during a war, would automatically revive on the restoration of peace. The world had not yet formed the conception of a total war capable of draining away the resources of the belligerents to the last drop, and riding roughshod over all private rights.

Given in some form a sufficient degree of international security to make external investment possible, what is to be its future? External investment is a matter of public policy in several aspects.

In the first place the possession of income-yielding assets abroad contributes both to prosperity and power. The process of external investment enters into the country's balance of payments as an 'invisible import'; the rights and assets acquired have to be paid for as much as any imported goods. But, the process once completed, the interest or dividends received constitute an 'invisible export.' So

long as the invisible import continues, the foreign exchange position is subjected to a strain, and with given rates of exchange the wage level and price level have to be so adjusted as to maintain a corresponding surplus of exports. But, when the invisible export begins, it starts a contrary tendency, and eventually, when the export of capital ceases, or is exceeded by the amount of interest and dividends received, the wage level and price level are adjusted to maintain a surplus of imports. The wage level has to be high relatively to the world price level, making the terms of trade, the visible imports acquired for a given amount of visible exports, favourable.

When the external investment takes the form of an interest-bearing loan, the investors presumably look for a higher rate of interest than at home. The difference may be small. But when it takes the form of a profit-making enterprise, the yield is swollen by the profits gained by activities for which there would be no opportunity at home. Profit-making is incidental to all economic activities which culminate in selling and, when those activities are extended, the field of profit-making is correspondingly widened.

In time of war external investments are a source of strength. The power of maintaining a portion of the country's imports without drawing upon its productive resources to send exports in return is itself an advantage. And, in so far as the external investments are in marketable form, they can be sold to neutrals, and the capital value applied to supplies necessary for the war. Even when they cannot easily be sold, a country with assets abroad will be regarded as an eligible borrower up to the limit at which its income from those assets is mortgaged.

But these advantages have not been allowed to go unchallenged. The unfavourable conditions of the years of depression immediately preceding the outbreak of war certainly gave abundant material for a case against foreign investment. The appreciation of gold in terms of all forms of wealth meant an increase in the burden of all debts expressed in terms of gold or of monetary units which were fixed in gold. This increase in the burden of the debt took concrete form in a difficulty of acquiring foreign exchange or of *transfer* to the creditor country. In reality the increase of burden and the difficulty of effecting payment occurred even where the debt was a domestic one, as was demonstrated by the thousands of bank failures in the United States. But the trouble was more complicated and more spectacular when an international frontier intervened between debtor and creditor, and default was imposed on the former by an exchange control enacted by his Government. It was contended that investors who had placed their money abroad had been hoodwinked; their belief that they could transfer even the income back home had been a delusion. The cynic said that a debtor country could only go on maintaining apparent solvency so long as its new borrowings exceeded its currently accruing

liabilities, and that, if the creditor countries cut off the new lending, the debtor countries had no choice but to default. If international investment were nothing more than a transparent trick by which the debtor countries plundered the creditor countries, ought not rigorous measures to be taken by the latter to stop it in the interest not only of the countries themselves but of the fond fools who were liable to be fleeced? Cynic answered cynic that, in the absurd economic system which the human race has saddled itself with, what every country seeks is not the acquisition of wealth but outlets for its exports, and that foreign investment creates an opening for exports, even if eventually nothing is received in return.

And here another aspect of the matter intrudes. External investment does not automatically bring about an excess of exports. On the contrary it creates a situation in which that excess has somehow to be brought about by other means. If there is a considerable discontinuous increase in external investment, the foreign exchange market may be overstrained, and the maintenance of equilibrium will require deflationary measures.

The purpose of exchange control, as distinguished from import restrictions, is to prevent an excessive export of capital. If public policy permits some export of capital, but only within limits, exchange control can be adapted to impose the desired limitation.

But that raises the question of selection among competing applications for permission to invest abroad, and, beyond that, of the further question whether there should be any discrimination among the purposes for which permission is sought.

So long as there is no other object in view than to protect the foreign exchange value of the currency, no discrimination is needed. Permission can be left to the haphazard of first come, first served. Alternatively a deterrent rate of exchange might be imposed on the acquisition of foreign exchange for the purpose of transferring capital, but a very searching control would be necessary to apply that method effectively and to prevent evasion, and it is open to doubt whether it is administratively practicable under peace-time conditions, when a postal censorship is likely to be objected to, and people can travel to make their bargains outside their own country's jurisdiction.

But if control of external investment is to be directed not merely to supporting the foreign exchanges, but to guarding against the losses and abuses to which it is liable, some degree of discrimination is clearly intended. One of the characteristics that gave London its paramount position as a centre of international investment in the nineteenth century was its freedom from any Government control. The principal Continental centres were always subject to pressure from their Governments, usually exercised on political grounds.

Discrimination among projects of external investment on political

grounds is open to the same kind of objections as discrimination in foreign trade. London's impartiality in this respect in the nineteenth century conferred on international investment the advantages that were secured in international trade by the most-favoured-nation clause; it guarded against the friction to which the international anarchy would otherwise have given rise.

British investors, it is true, showed their own political preferences, perhaps most conspicuously when they subscribed for Japanese war loans on the occasion of the Russo-Japanese war of 1904–5. But in general the reception of a foreign flotation in the City of London depended on the best judgment that the issuing houses, the stockbrokers and the investors could form of the security and the terms offered.

If nowadays there is a demand for Government supervision of external investment, the ground adduced for it (apart from the political) is principally to guard against the waste of the country's resources, perhaps more widely to direct investment into projects which, whether remunerative or not, are beneficial to mankind. That is not necessarily a philanthropic motive. One of the perils of external investment is the dependence on a foreign sovereign power for the enforcement of rights and for fair treatment in matters of legislation and administration, and investors are more likely to receive favourable treatment if their action is believed to have had beneficial results.

5. But this aspect of the matter cannot be dissociated from the parallel question of Government interference with investment at home. One of the accusations against the rule of let-do is that it permits an inordinate waste of resources by the investment market. Not only are investors frequently deceived by unscrupulous promoters or misled by those of bad judgment, but, even where good faith and good judgment are combined, there are always risks of loss owing to the limited field of vision of any private enterprise, and where nevertheless the enterprise turns out well, a disproportionate profit is usually left in the hands of the successful promoters. The result is that the actual necessary and desirable capital outlay may be only a modest fraction of the resources extracted from the investment market for the enterprise.

A mere supervision by a governmental authority would not go far to remedy these faults. To exercise supervision, or at any rate to carry it beyond the bare prevention of malpractices, such as fraudulent prospectuses and rigging of markets, the supervising authority must be able to exercise some independent judgment as to the merits of projects submitted to it. By what standards are the merits of projects to be measured? Capital outlay may be held to waste the resources of the community either (1) because it exceeds what is necessary to yield the designed output at the lowest real cost, or (2) because the output cannot be sold at a remunerative price, or (3) because the ouput, though meeting a demand, is regarded as undesirable.

There is little to be done by interfering with the first. One of the accusations against let-do is, it is true, that it dissipates an excessive part of the investors' savings in commissions and profits. But this is a part of the abuses of profit-making in general, rather than of the investment market. Profits are the principal source of savings, and promoters' profits, especially when received in the form of large sums at long intervals, are likely to be for the most part saved, the more so as the promoter's continuing success (if he makes the promotion of enterprises a career) depends very much on the extent of his own resources. Thus excessive profits on promotions and flotations, though made at the expense of other investors, do not greatly diminish the resources of the investment market.

A supervising authority could hardly take on itself the function of criticising the plans for installing the capital equipment of a projected enterprise from the standpoint of economy and efficiency without superseding the responsibility of the promoters and future proprietors.

Nor can the supervising authority interfere on the ground that there will not be a remunerative demand for the product. It cannot pit its judgment in that matter against that of the promoters unless it has at its disposal at least as good and skilled knowledge of the market as they. That would mean duplicating the special skill and experience by which the traders concerned earn their profits. A Government authority may, it is true, be in a position to organise a more comprehensive information service than any private trader, but the statistics and other data can anyhow be made public and facilitate the task of traders, promoters and investors.

If the Government is going to take up the duty of estimating the prospects of enterprises which come to the investment market to raise capital, it will find itself assuming the essential functions of private enterprise, and there will no longer be any room for the profit-making trader at all. A division of function, attributing to the Government the selection of the profit-making enterprises to be undertaken and to the traders the business of running them is surely inconceivable. It would be as impossible to saddle traders and investors with the loss on the failures as to leave the profits on the successes in private hands. Such a proposal can only be a half-way house on the road to collectivism.

There remains the question of restricting enterprises of which the output, even though profitable, is regarded as undesirable. This is a form of Government interference different in kind from those in which the Government claims to exercise better foresight in profit-making than the private trader. That public policy may reasonably justify a prohibition or deterrent of some kinds of enterprise is quite accepted. But a restriction of investment is not a very effective way of proceeding.

The restriction is much more effectively applied to the carrying on of the business than to its original equipment. Where the obnoxious business is not totally prohibited and made a criminal offence, permission to carry it on may be made subject to licence or to an excise duty. Investment in it will be spontaneously limited to what the output so restricted requires, and any direct control of investment would contribute little to the end in view.

If this kind of control of investment is advocated, it is rather with a view to a more comprehensive qualitative discrimination. If what is aimed at is not merely restraint of a very limited category of undesirable practices, such as gambling and drug-taking, but a general allocation of economic activities among different forms of production according to the relative desirability of the products, a system of licences or excise duties and subsidies would be extremely vexatious, and very difficult to adjust exactly to any prescribed policy. But a regulation of investment could never be an adequate substitute for it. New capital flotations in the market could be controlled, but it would be very difficult to exercise any effective control over the raising of capital by private arrangement. And not merely the raising of capital but its application would have to be controlled. Capital outlay might be steered away from the less desirable (but more profitable) enterprises, but it would be easy in many cases to adapt equipment primarily installed for an approved purpose to serve another.

Indeed there is no need to dwell on the futility of hoping to dissociate production from the motives of price and profit, while still relying on those motives as the fundamental economic incentive. So long as profit-making provides the remuneration of enterprise, attempts to drive traders in directions which do not promise the best profits can only encounter insurmountable resistance. Such a policy inevitably leads up to collectivism; the State must in some way take upon itself the detailed direction of production and use the traders as its agents.

6. Competitivism relies on the rate of interest to maintain equilibrium in the capital market. In the days before an investment market had been evolved, interest or usury was an object of moral condemnation, and often of legal prohibition, and those who exacted or paid it were driven to various shifts to disguise it or apologies to excuse it. In recent years voices have once again been raised against it. The attack is often directed not so much against the ordinary investor who holds the debentures of a company, and may be regarded as accepting a smaller share of the profits than the shareholders in consideration of a smaller risk, as against the bank which creates money out of nothing, and exacts interest when it lends the money to its customers, or especially to the Government.

The case stated in this shape is easily demolished. Banks do, it is

true, create money out of nothing; they exchange debts due from themselves to their customers for debts due from their customers to themselves, the former serving as money and the latter yielding interest. But, when the banks' debts to their customers yield no interest, that is because the business of using them as money by assigning them from one creditor to another is both convenient to the customers and expensive to the banks. Banking is a profit-making business, but the profits are not conspicuously higher in proportion to shareholders' capital than in other kinds of profit-making business. The nationalisation of banking is sometimes advocated as a method of raising money free of interest, but the net financial advantage would be no more than to eliminate the banks' profit, and a similar gain may be made in any other business which the Government might take over. Underlying such schemes is usually a childlike faith in the possibility of the Government raising unlimited resources by creating money out of nothing. In reality the amount of money that can be created, whether by private enterprise in banking or by a nationalised system, without giving rise to all the evils of inflation and unstable money, is limited. The Government could raise the same sum from a nationalised banking system as it could borrow from privately owned banks, and would merely incur the expense of running the banks in place of the liability for interest.

Those who denounce interest as an essentially vicious institution would not stop there. They would press for the abolition of all interest, whether on money lent to the Government or on money lent to traders.

The abolition of interest is sometimes opposed on the ground that an inducement is necessary for saving. He who postpones expenditure, it is said, is giving up something, and, unless there is some reward or compensation for doing so, there will be no saving at all. That is a misconception. People save because they anticipate a future time when the expenditure of the money will be more advantageous to them than in the present. Or if their saving goes beyond what such anticipation would justify, they hope to endow themselves or their families with the power that an accumulation confers. In some cases the prospect of a perpetual income which interest provides is an additional attraction, but in others accruing interest makes it possible to accumulate a given fund with less effort of saving. It might even be that the absence of interest would actually cause an increase in saving.

But these calculations are really not very relevant if, when interest is suppressed, profits remain. For investment in shares would provide the opportunity of securing an income from a capital sum. There would still be people who would forgo any investment income if they could thereby make their capital more secure, but evidently money lent free of interest would have to be lent on demand. It would in

fact be retained in the form of 'money' (as ordinarily understood to include bank credit). There would be no inducement to the lender to allow the borrower a long notice, running to months or years, still less to make a long-period loan. *Some* interest is necessary, as Lord Keynes has pointed out, as compensation for forgoing liquidity. The investor who makes calculations for the future, and is willing to tie up his money for two or five or even thirty years, would nevertheless insist on its being payable on demand if he were offered no compensation at all for tying it up. The right to demand it might be useful to him in some contingency, and he will see no reason to part with it if he is to get nothing in return. But if he is in any case willing to tie it up, *any* interest (above a derisory minimum) will induce him to do so. Yet when there is an investment market offering him a rate far above the minimum that he would accept, he will take advantage of it, and insist on the highest rate the market will yield.

What the market will yield depends on what borrowers are in a position to pay. When there is a pressure to raise capital in the investment market in excess of the available resources, the market raises the rate of interest so as to deter borrowers and reduce their demands to the extent required. If there were no interest, traders would not be able to borrow at all except on demand, and few of them would be willing to run the risks inherent in big demand liabilities. Any trader except a banker, or one whose business approximates closely to that of a banker, would rather borrow even at a high rate of interest for whatever agreed period, long or short, suits him than free of interest on demand. To abolish interest would be to abolish borrowing in business altogether. Accumulation would be confined to three forms, (1) consumers' instrumental goods, (2) participations in profit-making enterprises, and (3) money. Money would inevitably mean either currency, or demand loans to the Government. If commercial banks existed, they would derive their remuneration wholly from charges made for services rendered, and would hold money to an amount equal to their liabilities, yielding no interest.

Such a system would involve serious and obvious dangers. People who would accumulate idle money so long as no sufficiently attractive shares or participations offered, would be attracted by some new opening, and would want to contribute their money to be laid out on the appropriate capital equipment. If, as is very apt to happen from time to time, there is a noticeable acceleration of the activity of business as a whole, there might be a widespread tendency to place in business enterprise savings of money previously held idle. There might well be occasions evoking a release of money into consumption on an exceptional scale, and swelling the demand for goods. The presence of a great quantity of loose money, withheld only by the voluntary discretion of the holders from expenditure on capital outlay or on con-

sumption, would be a perpetual threat to monetary stability, to which in the absence of interest there would be no ready corrective.

Interest, as we have seen (above, pp. 111 and 81–3), enters as a regulator into the capital markets, the long-term rate of interest governing the investment market and the short-term rate governing the credit market. Lenders can, it is true, exercise an overriding influence in either market by refusing to lend, but concerted action on their part requires some commonly recognised signal, such as the market gives by a rise in the rate of interest.

But, in any case, it would surely be an absurdity to suppress interest, and leave profit-making untouched. In the middle ages, when the extent of profit-making transactions was small, and the trader's profits were the direct fruit of his skill and exertions, a moral contrast could be convincingly drawn between profit and usury. But the moral distinction between the bondholder and the inert shareholder is not so definite. To forbid interest and permit dividends would not be an intelligible distinction.

7. Yet there is another possibility to be taken into account. The smooth working of the competitivist system requires that there always be sufficient opportunities of capital outlay to employ accruing savings. The rate of interest is the instrument by which the investment market restricts capital outlay and confines the raising of capital to such amount as its resources can provide. But if the opportunities for capital outlay were insufficient to employ the available resources, the rate of interest might theoretically fall to zero without reaching equilibrium. Any piece of capital equipment has to earn its own maintenance and depreciation before it can provide any margin for interest, and, if industry is already fully equipped with every appliance that can pass this test, without using up current savings, a further demand for capital could not be evoked even by the offer of loans free of interest. So long as there is a demand for improved residential accommodation and instruments of consumption, such as furniture and works of art, there is room for accumulation in that form, and for a rate of interest adjusted to the consumers' demand. But that too may reach satiety. All these things, it must be remembered, cost something for depreciation and maintenance, however low the rate of interest may be.

When capital outlay falls short of current savings, that means that disposals, consumption and capital outlay together, fall short of the consumers' income and therefore of production. The discrepancy appears in the form of an addition to stocks of unsold goods. In fact, since accumulation is necessarily equal to saving, a shortage of other forms of accumulation inevitably takes that form. A persistent excess of production over sales confronts industry with a shortage of demand, which can only result in a progressive decline of productive activity, and growing depression. Depression will

reach its limit only when net savings have been reduced by loss and distress to zero, or, if capital outlay has not reached a state of absolute satiety, to such amount as remunerative capital outlay can use.

But in any case a condition of things in which equilibrium can only be attained at the cost of depression and impoverishment clearly signifies a breakdown of the economic system. The depressions which the world has actually experienced in the past have been susceptible to treatment by monetary means. A shortage of demand for goods can be cured by an expansion of the flow of money. And if the flow of money could be expanded up to the point at which the outstanding stock of money is continually increasing by an amount equal to the unemployed savings, that result would be attained. But some means of *spending* this excess would be essential. The excess constitutes a growing deposit liability of the banks, against which, on our hypothesis, their only possible asset is likely to be an equal Government indebtedness. It is therefore the Government that must do the spending. It may, for example, remit taxation, and meet the resulting deficit by borrowing from the banks. The tax remissions will probably give rise to still more saving, and conceivably the Government might find itself meeting the whole of its budget expenditure by a creation of money. Alternatively the Government might use up the borrowed money on capital outlay of its own, a public works programme outside the budget of current expenditure. That presupposes that the exhaustion of desirable openings for capital outlay, from which we are assuming private enterprise to be suffering, does not extend to Government enterprise. A quite unwarrantable assumption. The Government does, it is true, apply other tests than that of pecuniary gain in deciding whether to undertake capital outlay. But that does not mean that the *beneficial* capital outlay open to it is unlimited. There is no reason to expect that private enterprise will reach the limit of remunerative projects sooner than the Government reaches the limit of beneficial projects. And if, when the former limit is reached, the Government fills the gap by expanding its own capital outlay, the latter limit is likely to be soon reached too.

However, it is clearly possible for the Government to keep things going by using up surplus savings on its own current expenditure for a considerable time, and perhaps indefinitely.

Lord Keynes has described the conditions attendant upon a glut of capital as the euthanasia of the rentier, in that a superfluity of money seeking investment would reduce the rate of interest to zero. But the effect would not be the same as that of a prohibition of interest. There would still be payments for loss of liquidity and for risk. The Government would find it prudent to avoid an embarrassing enlargement of its floating debt by borrowing for long terms at such rate of interest as

might be necessary to induce investors to tie up their money. Traders supplementing their share capital by means of a debenture debt would offer higher rates in consideration of additional risk. And short-term borrowing at interest would continue undisturbed. The convenience of supplementing working capital by means of bank advances would be unaffected. Traders' needs of such advances would probably be diminished, since many of them would be led by the ease of raising capital to cover their maximum needs of working capital by issues of shares. But some would have to pay substantial rates of interest on long-term borrowing, and others would find their business outstripping their capital resources. For one reason or another many would find short-term borrowing convenient.

Thus the control of bank credit through the short-term rate of interest would survive, though possibly diminished in efficacy by the decrease in the volume of bank advances. The banks, however, would have to hold some kind of assets to fill the gap caused by the falling off of their advances to traders. They would probably hold medium-term Government securities, which, though yielding a very low rate of interest, would be in demand among investors and could therefore be sold in case of need.

Thus even if there were a complete glut of capital, leaving no new openings for remunerative capital outlay, the indefinite expansion of bank credit or loans on demand, with its perpetual threat of inflation, need not arise. But there might be an indefinite expansion of the national debt uncovered by any revenue-producing assets. That would become embarrassing, even if some economic change did not revive the rate of interest, for every Government loan would have a due date, and ever-increasing amounts would be coming up for renewal. It would never be possible to count on the glut of capital being a permanency. Its continuance presupposes a suspension of the deepening of capital. That is to say there must be no known labour-saving appliances, not yet employed in industry, which could profitably be adopted. Even if that were momentarily so, some new discovery might at any time restart the deepening process, and its demands upon the investment market would offer more attractive openings to holders of Government securities. Holders of maturing securities would reinvest their money in enterprise, and other holders would offer their securities for sale. Market quotations of securities would represent once again a substantial rate of interest, possibly a very high rate, if the demand for industrial investments had to be kept in check.

Prudence therefore requires that an indefinite growth of the national debt should be avoided. A sinking fund would do little towards that end, for it would supply the former holders of the securities paid off with fresh money to invest. It is sometimes assumed that a progressive depreciation of the currency unit in terms of wealth would be

a legitimate way out. Experience shows that over long periods a progressive depreciation of the wealth value of the unit does occur, and, so long as it is kept within such moderate limits that investors and people engaged in financial transactions are not aware of it, it does no harm. But if the depreciation were a result of *deliberate policy*, that condition could not be fulfilled. People would be unwilling to tie up their money for long periods and could only be induced to do so, if at all, in consideration of a rate of interest high enough to compensate for the anticipated depreciation. High rates of interest are a well-recognised result of a distrust of the currency. If the Government were avowedly relying on depreciation to meet its liabilities, no rate of interest could be high enough, for the higher the rate of interest the greater would be the accumulated liability of the Government and the greater therefore the depreciation required.

A solution would seem to be a capital levy. A capital levy would withdraw resources from the holders of property and industrial capital as well as from the holders of Government securities. Even a sinking fund may be raised by forms of taxation that diminish savings, and a capital levy is a tax which extinguishes savings on a large scale.

All this is in the realm of hypothesis. Even in 1935, before re-armament and the portents of coming war began to make heavy demands on the world's capital resources, Lord Keynes regarded the euthanasia of the rentier only as a contingency that might occur in the course of a generation or so. After the present war the world will be faced for years with heavy capital outlay to overtake arrears of maintenance, renewals and improvements, and to make good war damage.

But a time will come when this phase is done with. If the peace of the world is successfully established, a satiety of capital outlay is a possibility which should not be ignored. Moreover a not unusual approach to the treatment of the trade cycle and of trade depressions among present-day economists is to assume that this state of satiety already exists. According to this view the depressions of the past twenty years (if not of earlier times) have been due to accumulation outrunning the openings for capital outlay, and so resulting in a shortage of demand for capital goods. In my own view the world is ever so far from that state of things, and the shortage of demand is palpably traceable to a different cause, and has in fact been the natural and intended result of measures deliberately taken to diminish the flow of money. But, so long as these matters are a subject of controversy, a satiety of capital outlay cannot be neglected as entirely visionary.

CHAPTER XIX

COLLECTIVISM AND INCOMES

1. THE economic institutions of the world have become the object of hostile criticism and insistent attack. In the preceding chapters we have explored some of their most glaring defects, and expedients which are or might be applied to remedy them. And in the course of this exploration we have repeatedly been led up to the alternative of abandoning competitivism altogether in favour of some form of collectivism.

First of all, if total war remains an ever imminent contingency, and armaments the paramount end of the economic activity of every community, it might be found impossible to maintain the desired concentration of effort by the happy-go-lucky inducements of profit-making, and economic activity might have to be directed by a comprehensive authoritarian discipline.

Secondly, even if peace can be so far assured that armaments can take a relatively subordinate place, and welfare can be the main economic objective, will profit-making be tolerated as the means of organising effort for that purpose ?

Thirdly, given that profit-making is after all to be acquiesced in, the disorders which have broken into the smooth working of competitivism remain to be encountered, and solutions have to be found for the problems of monetary stability, of wage policy, of foreign exchange and international trade, and of accumulation.

It is only too easy to build up a devastating indictment on the agonies of unemployment, the perversity of organised labour, the obstruction of markets, the paradox of poverty in the midst of plenty, the destruction of produce at a time of distress, and the flagrant inequalities of wealth and opportunity, and to end up with an appeal for a root-and-branch change. Over and over again impassioned invective declaims that competitivism has broken down, let-do is obsolete, and nothing less than a revolution sweeping away all these effete and discredited ideas will effect a cure.

If competitivism is to continue, and profit-making is to remain the primary motive of enterprise, two conditions are essential, stable money and a recognition of profit-making as legitimate.

After what has been said (Chapters V, VI and XV) there is no need to labour the plea for stable money. If it is the solution of the two problems of unemployment and the foreign exchanges, stable money can rehabilitate competitivism as nothing else can. That there must be a residue both of unemployment and of foreign exchange troubles may be admitted. These will be due to inevitable discontinui-

ties, which any system is bound to encounter, and they must be treated with palliatives.

But under competitivism stable money itself presupposes an acceptance of profit-making. If the flow of money is to ensure full employment, that must mean that it ensures normal profits. It is, as we saw in Chapter XVI, very much a question of wage policy. If the existence of normal profits, that is to say, a level of profits no more than sufficient to provide the requisite stimulus to enterprise for maintaining full employment, is seized upon as a signal for demands for higher wages, the result can only be chronic unemployment combined with a progressive depreciation of the wealth value of the monetary unit, the worst of both worlds.

The possibility of an irremediable breakdown of competitivism cannot be excluded, and it is time we turned to consider the alternative, the rival system, collectivism.

Any examination of the merits or of the practicability of collectivism ought to start with a critical examination of communism where it has actually been tried, under the Soviet Union. Unfortunately our knowledge of communism as practised under the Soviet is so inadequate that we can derive little guidance from it, and we must rely mainly on reasoning from principles.

The governing principle of collectivism is the suppression of private profit-making enterprise, and the substitution of the State, acting through appropriate agencies, for the profit-making trader. In the case of a company the State supersedes the shareholders and assumes both ownership and powers of control. It is not essential that private property other than that used in profit-making enterprise should be interfered with, nor even that all profit-making should be completely eliminated, so long as the enterprises tolerated are on a small scale. Nor is it essential that the incomes derived from interest should be suppressed, though it is likely that the same considerations of public policy that warrant the suppression of profit-making would point to the extinction of the big accumulations of wealth derived mainly from profit-making in the past. Heavy taxation and limitations on inheritance and bequest might accomplish that end without any violent confiscation.

If the State is to supersede the profit-making trader, it must assume his responsibilities. In the first place it will find itself responsible for conducting productive enterprises. There has been abundant controversy on the relative fitness of the State and private enterprise for the technical business of production, and it is hardly possible to say whether the change would on the whole involve a gain or a loss of efficiency. A collectivist State must of course be assumed to take over industry as a going concern from private hands. Industry has been built up by centuries of experience, and can only be carried on by the

people to whom that experience has been handed on, and the collectivist State must work through them. They, unless they migrate to another country, will have no other opening for using their skill.

Profit, as we have seen, is not only or primarily the reward of efficient and economical production, but is above all the reward of selling power. In appropriating to itself the privilege of profit-making the State therefore must undertake the task of selling.

One part of the task of selling calls for no very outstanding faculties or exertions. A certain portion of the productive power of the community is applied to supplying staple products for which there is an unfailing demand, and which retail dealers must always stock. Such products are steadily sold, and, as fast as they are sold, orders are given to producers to replace them. The volume of orders corresponds closely to the volume of demand (except where a change of practice in regard to the amounts held in stock interposes to cause a temporary disparity), and neither dealers nor producers need display any great initiative or originality in regulating them. The substitution of the State for the private trader in that sort of business may well be a simplification, avoiding the restless endeavours of traders to encroach on one another's sales.

But the continued production of things already in demand is evidently no adequate end of economic action. To be content with it would be to abjure progress; it would be a confession of failure. And not only does progress continually disclose new and better ways of meeting needs, but it discloses new needs, and, even apart from progress, the good life needs variety. Variety is an essential characteristic of creative products, and progress itself is constantly enlarging the scope of creative products.

If the collectivist State is to be a worthy instrument of welfare, it must provide for desirable innovations in its products. It must select individuals with the appropriate talents, and it must employ them in positions where they will have opportunities both of devising innovations and of giving them concrete shape to be enjoyed by those in the community who can appreciate them. The innovations include both the scientific and the artistic, new devices for meeting needs previously not met at all, or not so well, and new varieties of pattern and design, and they must range through the whole field of production.

Under the rule of competitivism and let-do innovations are regarded by the trader primarily as means of stimulating sales. The test of their success is the attraction of buyers, and the process is assisted by salesmanship and advertisement. Under the rule of collectivism that test need not be excluded; the proof of the pudding is in the eating, and of the product of industry in its sales.

To some extent saleability would almost inevitably be the test applied by a collectivist State. A remunerative price would not neces-

sarily be insisted on for everything. It might be judged conducive to welfare to supply some articles below cost, and to cover the deficiency by exacting a high price for others. But that would only be justifiable if there were some good reason for encouraging the consumption of the former and discouraging the consumption of the latter, or at any rate making them the vehicle of extracting revenue from the consumers. Apart from any such reasons the aim would be to make all products equally remunerative, restricting the output in each case to the anticipated average amount of sales. Actual current sales at the remunerative price would be the primary criterion, but account would be taken both of the experience of the past, and of any disturbing cause believed to be affecting current sales, or any that might be expected to affect them in the future.

2. In following this course, the collectivist State will encounter the same problem of co-ordinating wages, prices and money as has caused such infinite trouble under the rule of competitivism. In assuming the direction of industry and superseding the profit-making capitalist, the State becomes responsible not only for supplying the consumer's needs, but also for accumulation. That large share of the community's saving that comes out of profits is in its hands, and so also, on the other side of the account, is the capital outlay of industry. The State determines the rates of wages in the industrial concerns that it controls, and must so adjust wages and prices that it realises a revenue, in the form of profit, sufficient to meet its overhead expenditure on defence, administration, law and order, and to leave a margin equal to whatever rate of accumulation is deemed desirable.

The collectivist State need not rely exclusively on profit for its revenue. It may prefer to resort to taxation for a portion of its needs. For example, if individual savings are permitted on a considerable scale, it may be desirable to restrict the endowment of families by a scale of death duties. If local authorities are to have any effective autonomy, they must have powers of local taxation. Taxation may also be found a convenient form of book-keeping. In Soviet Russia, for example, besides the collective farms and co-operative producers, the State industries pay heavy taxes on their output, very similar to the British purchase tax. These taxes are simply a device for prescribing what share of the profits of each industry shall be available for the various forms of Government activity, which do not support themselves by the sale of their products. Each industry can be left so to settle its own output and prices as to cover its costs, pay its tax, and leave a sufficient margin of reinvested profits to provide for its own development.

But that does not mean that each industry can be completely autonomous. It must be subject to central control in at least two respects, the rates of remuneration of those engaged in it, and the scale of future

development to be provided for. The amount of reinvested profits that an industry can accumulate depends on the present demand for its product. But present demand may not be at all a good index of the productive capacity that will be needed in the future. The industry has monopolistic powers, and even in a given state of demand, and with a given rate of taxation on output, price can be varied within limits wide enough to make a great difference in that residue which constitutes reinvested profits. There will be some industries which, if they used up all their reinvested profits in development, would extend their capacity too fast and too far. And there will be others which are due for an enlargement greatly in excess of what their reinvested profits would pay for, and to which the central Government will want to supply capital funds. There must be some direction from the centre as to the disposal of surplus profits. Whatever the machinery, the ultimate responsibility for determining both prices, and the direction in which the accumulating capital resources shall be applied to extensions of productive capacity, must inevitably rest on the central Government. All measures of decentralisation are bound to be delegations of this responsibility, subject to modification and revocation.

3. Even more fundamental is the central responsibility for rates of wages and salaries. The most extreme forms of collectivism require all incomes to be derived directly from the State, and either all incomes to be equal, or incomes to be proportioned in some manner to needs. Neither of these principles, however, is a necessary consequence of the suppression of profit-making. Even if all profit-making employment were excluded, and incomes derived from interest were either suppressed or reduced to negligible proportions, there might still remain some incomes derived from independent work involving no wage-paid employment—for example, professional work paid by fees, artistic and literary work paid by fees, royalties or sales of products, and such occupations as single-handed dressmaking or hairdressing. Nor would wage-paid labour for personal services, such as domestic service, where there is no profit-making, necessarily be ruled out. It would be pedantic to exclude as 'profit-making' every kind of professional or artistic work that involves costs in the form of expenditure on materials, and it would not be unreasonable to tolerate quite a considerable amount of small-scale profit-making business employing in each case a very small number of wage-paid workpeople. If collectivism is intended only to prevent the abuses of large-scale profit-making, it need not interfere with small shops, handicrafts and agricultural holdings, though wholesale dealing or financial operations, even if the numbers employed were very small, would be excluded. Co-operative enterprise, in which the profit is divided among those who do the work, may be allowed (as it has been extensively both in agriculture and in industry in Russia), but unless the co-operators are

made accountable to the State for their profits, there is a danger of their securing disproportionately enlarged incomes.

But in any event employment by the State will dominate the labour market. Independent incomes cannot be allowed to develop on a scale which would compete with the policy of the State in fixing rates of remuneration.

What then is that policy to be?

Doctrinarian socialism has evolved the principle: From each according to his ability, to each according to his need. But it does not seem likely that human nature will stand a complete dissociation of remuneration from services rendered. Russian communism was perhaps at the outset, in the minds of some enthusiasts at any rate, pointed in that direction, but the tendency was soon reversed, and very substantial differences in remuneration based on differences in the value of services rendered are now well established. Ambition insists on tangible rewards in recognition of merit and of success.

Moreover, even if distribution according to need were adopted as the ideal to be aimed at, a sudden sweeping away of all incomes above the low level representing equality, modified only according to need, would be the cause of great hardship. Need is almost inevitably interpreted to mean the need arising from tangible causes such as family responsibilities, vocational expenses, or disabilities. But most people need, in a very real sense, the incomes they have been accustomed to. They develop habits and tastes, sensitiveness and fastidiousness, plans and ambitions, the satisfaction of which cannot be contentedly surrendered.

Much of this, it may be said, is nothing but a conventional standard of living, which contributes little to real welfare, and can be given up with no more than a short-lived transitional sense of loss. And some is mere ostentation, frivolity or waste, the cessation of which would be no loss at all.

But, along with much misguided and misdirected expenditure, the well-to-do classes of modern civilisation have made a contribution to the art of living. They have been in a position to experiment in the business of applying resources and leisure to welfare, and their experimenting has not been fruitless. If there is pressure from the not-so-well-to-do to share their resources, that is not because those resources are misspent, but because the opportunities they offer have been proved to be worth having.

Erring humanity can only find the good life by trial and error. Experience builds up a tradition, and those who are exempt from the pressing need to guard themselves against want and distress are best placed to have and to use the experience. It is among them that a household can be organised, equipped and adorned to supply a fit setting for a good life; it is they who can procure the implements of

culture and intelligent intercourse and the means of travel; above all, it is they who can have the advantages of care and skill in education. Unhappily the mere possession of means does not ensure the acquisition of any of these things, but surely human nature has somewhere engrained in its essential consciousness such a discernment of the good as will give guidance to its experimenting.

The first charge on the community's resources ought to be adequate utility products for all. If equality of incomes, adjusted to assessable needs, were the only way of attaining that end, the case for it would be made out. But economic progress has moved far beyond that stage. It is often said that mankind has left the age of scarcity behind, and has reached the age of plenty, and in that there is much truth. There is productive power sufficient in the aggregate for an ample output of utility products, with a vast margin left over for superfluities and creative products. But habits and therefore needs adapt themselves to supplies, so that the superfluities of one generation become the conventional necessities of the next. Misdirected expenditure is to be found among the small incomes as well as among the great and the moderate.

The Communist Manifesto declared the class war. Class distinctions arise out of differences in wealth, but in themselves are something more. Experience in handling, using and enjoying the things which constitute wealth confers appreciation and discernment of qualities and values. That does not mean exclusively discernment in matters of art and intellect, but it includes also, on a lower level, knowledge of the uses to which things can be put, for instance, and appreciation of the qualities constituting good workmanship, and of the value residing in a fashionable pattern or in rarity. This lower kind of epicurean culture is not a very vital component of the most excellent kind of welfare, but it is essential to material progress beyond a certain very modest level.

Along with their experience in making use of wealth, the well-to-do also have the advantage of choosing the best available means of education for their children. Here again it is rather trial and error than a directing wisdom that is at work. But in the course of generations trial and error can produce results. Upper- and middle-class education, as it is evolved, is not confined to instruction but extends to character, morals and manners. These things do, it is true, depend much more on parents themselves than on schooling. Schooling, however, is in general essential in order to impart knowledge, and the school teachers are placed in a position to supplement parental care and influence. Intensive school education, permitting of individual concern for pupils on the part of selected teachers, is expensive.

Lavish expenditure on education does not necessarily produce good results. And it may be that the children of well-to-do families often

miss something which those of less material advantages gain. They may be too sheltered, and grow up with a narrow outlook, valuing their privileges both too much, in that they count themselves superior beings, and too little, in that they have no understanding of want and struggle. But whatever they lose, the advantages to be derived from their experience are real, and ought not to be hastily destroyed. Some day economic progress may permit of everyone being well enough off to have these advantages. But, as things are, there is a case for preserving the grading of incomes up to a middle-class level.

4. But how high? In the profit-making world it is found worth while to pay salaries of several tens of thousands of pounds to those who are highly skilled in the organisation and management of industry, or in finance or selling. A collectivist State, being the only available employer of people with these talents, can dictate their rates of remuneration. At the same time they, or some of them, will be very much alive to their value to the State. The value of their services can be reckoned in terms of money, and those responsible for appointing them and making the best use of their aptitudes will be quite aware of that.

A man whose capacity for such a position has been fully established and recognised may well be tempted to stipulate for high pay as a condition of filling it. And if the claims of some are granted, others must be levelled up. Unless, therefore, the governing authorities make a stand and impose a moderate maximum limit as a matter of principle, the outcome will be a new plutocracy.

Will the governing authorities make a stand? Why should they? They may be tempted to acquiesce even in extravagant demands, and then assign correspondingly high incomes to one another. Historically, as we have seen, the vogue of communism as a political cause has been mainly due to the dissatisfaction of democracies with the inequalities resulting from profit-making. It is of little use to put an end to profit-making unless there are safeguards against the same inequalities reappearing in a different form.

The alternative to democracy in modern politics is totalitarianism, discipline and repression imposed by a dominant party. The dominant party, being exempted from the rivalry of opposition parties, becomes a governing class, the members of which are in a position to exploit the resources of the community in their own interests if they so choose. Nor can it be safely assumed that whatever inequalities may arise from the misuse of this power will be small in comparison with those arising from free profit-making. The vast fortunes made in the Republican period of Rome were not made by trade or industry and only to a subsidiary extent by finance. They were primarily derived from the uncontrolled exploitation by proconsuls and propraetors of the powers of government which they exercised in the provinces. The governing

class was composed of a limited circle of families the members of which appointed one another to these lucrative posts.

Feudalism was also built up on the economic exploitation made possible by political power. In eighteenth-century France the centralisation of government had reduced the local jurisdiction of the feudal *seigneur* to a subsidiary position, but the aristocracy had acquired the functions of a governing class, and retained its feudal privileges, fiscal exemptions and rent rolls.

A governing class formed on the totalitarian plan from a party of communist fanatics might be proof against the temptation of exploiting their power in their own material interests. Indeed they might guard against inequalities more effectively than a democracy of apathetic or venal electors. But there can be no security that party fanaticism will last. A ruling party will not easily exclude recruits whose motive is rather personal ambition than zeal for the cause. A revolutionary party, so long as it is revolutionary and therefore in opposition to the established Government, does not attract half-hearted supporters. But when it achieves its revolutionary aims and becomes itself the established Government, there is no longer an automatic test of the sincerity of membership.

5. The rise of communism as a revolutionary movement, directed against established institutions which were predominantly democratic, led to an antagonism between communism and democracy, which had a false basis. Communism in its origin was democratic, and cannot be permanently reconciled with any other political institutions than those of democracy.

The cleavage between communism and democracy has not been exclusively attributable to the association of democracy with the established institutions of profit-making and burgessry. There has been another and more tangible motive at work. If revolution be ruled out, collectivism can only be established in a democratic State by the support of a majority of the electorate. But there is no way of ensuring that what the electors have decided will not be reversed by them, perhaps within a very few years. A fundamental change in the economic structure of society is sure to cause much transitional distress, and it must inevitably pass through an experimental phase in which many mistakes will be made. A supporter of communism will seek somehow to secure the experiment against interference for long enough to give it a fair trial.

But surely an abandonment of democracy is not the way to gain this security. Repression is perhaps more effective under modern conditions than in the less closely organised States of the past. Nevertheless institutions which are maintained by repression against the will of the majority will always be precarious. It may be argued that what has to be guarded against is not an actively adverse majority, but

a majority of indifferents, whose votes count, however little they care for the issues. But the real danger is not that a communist experiment once started will be prematurely abandoned by a majority of indifferents; it is rather that communism may be started by a small but active party of enthusiasts with the acquiescence of the rest, and that the majority, when they discover its far-reaching effects upon their own lives, may cease to be indifferent and become very active supporters of a reversal. What is wanted is a full understanding of the change on the part of the mass of the people. If it is made by the decision of a democratic majority, people are much more likely to enter upon it with their eyes open than if it is brought about by a revolutionary stroke. Democratic action not only secures the support of a majority, but it ensures open discussion which enlightens even the unwilling minority as to the significance of what is being done. It also enables the successful majority to foresee to some extent the hardships and grievances to which their proposals will give rise, and to adapt their plans so as to reduce the future opposition to a minimum.

Democracy will not absolutely secure a collectivist State against a return to the abuses of inequality. An apathetic or corrupt electorate may allow a new governing class to grow up and entrench itself in privilege. Not only may those in control of administration and industry award one another extravagant salaries and perquisites, but it would be easy to reintroduce profit-making by what would appear to be little more than an unobtrusive change in the accounting system. One who is in charge of a big industrial or commercial unit under a collectivist State will be in control of large accumulations of funds, and a very rigorous financial control would be necessary to prevent him from using the funds in his own interests. An audit would be necessary to ascertain not only that the funds were employed only to acquire goods and services for the purposes of the industry, but that the goods and services themselves were actually so used. A very thorough-going audit applied to cost accounts and stock accounts would be necessary to exclude the possibility of misapplication. And if saving the time and labour of those in responsible positions is regarded as a legitimate use of the resources of the industry, one who enjoys that use may be in effect living the life of a very wealthy man, even though his income look moderate. A slight relaxation of the accounting system may enable him to withdraw the sums applied to his private use from scrutiny, and from that it would be but a step to allowing him to farm the concern and pocket all profits in excess of a fixed annual payment.

One of the greatest objections to collectivism is the subjection of all executive action to a hampering external control. In so far as the control is administrative, it can be greatly lightened by delegation and decentralisation. One in command of an industrial concern can

be given the same kind of discretion as one in command of an army. He is given a free hand, and made responsible for success or failure. But financial control cannot be dispensed with, or diminished below a certain limit. Money can be eliminated from all wholesale operations; that is to say, payment need not be made for supplies or services received by one State-controlled concern from another, and balances of currency or bank credit need not be maintained for such transactions. The handling of money can thus be confined to those who actually pay out wages and salaries, and those who bring to account the proceeds of retail sales in shops, the fares in transport concerns, the receipts of places of entertainment, and other money transactions of a personal character. Here the same safeguards against leakages and misappropriations can be used as under private enterprise.

But by excluding transfers of money from wholesale transactions the need for financial control is not avoided. A money valuation of the goods and services involved is essential to cost-accounting, and there must be substantially the same book-keeping as if money actually passed. Nor would anything be gained by eliminating the valuation and the book-keeping. For what has to be guarded against is the misappropriation of the things themselves. There must be an inspection of the transactions sufficiently searching to prevent too lavish indulgence in 'official' residences, 'official' locomotion, 'official' entertaining, even 'official' works of construction for industrial purposes outside control.

The hampering effect of the control, and the danger that, however close and efficient it may be, it may still fail to prevent misappropriation or downright peculation, would always provide powerful arguments in favour of a relaxation which would amount to nothing less than a reinstatement of profit-making. If that is to be avoided, the best defence will be an instructed support of the established system in a democratically organised society.

Syndicalism aims at putting the essential control in the hands of the workmen, who can exercise vigilance over the directorate of the concerns in which they are employed. But there is then a danger of profit-making on the part of the workmen themselves, producing fortuitous disparities between the earnings in different industries. Without, however, going to the length of putting the responsibility of control upon the workpeople, the collectivist State might call upon them to appoint representatives to ascertain and to certify that the resources in the hands of the industry are applied to their proper uses and are not diverted to concealed perquisites or otherwise misappropriated.

Whatever the detailed methods of control may be, a democracy convinced of the merits of collectivism, or at any rate determined to prevent the abuses of profit-making, is much more likely to make a success of the system than a governing class, however constituted.

6. But democracy has not been designed exclusively or even primarily to guard against economic inequalities. It came into being as a defence of liberty. *Political* liberty, in a narrow sense of participation in government, is identified with democracy. But liberty is a principle of many applications.

Personal liberty means freedom from arbitrary coercion or oppression by the executive power. Historically democracy has been closely associated with the vindication and maintenance of personal liberty against the interference of an autocracy or a governing class, and against customary restraints and prohibitions. Democracy does not necessarily secure personal liberty. If it is to do so, the electorate must themselves appreciate the issues involved, and be on the alert to prevent any abuse of power. Infringements of personal liberty are not limited to abuses of executive power; they may be enacted by law, and in a democracy which does not care for personal liberty the legislature may pass repressive and tyrannical measures. That is particularly apt to happen where the measures are directed against unpopular minorities.

A benevolent autocrat or governing class may show more devotion to liberty than a democracy, and may exercise executive and legislative power in such manner as more effectively to preserve it. But a democracy is very much more likely to be an effective guardian of personal liberty, for every member of the electorate may well fear that arbitrary action directed against his neighbour will be a precedent for arbitrary action directed against himself.

To guard against arbitrary abuse of the executive power, the independence of judges and courts of law must be secured, and the powers of arrest, detention and punishment must be strictly subordinated to the requirements of criminal justice. But to safeguard liberty, the criminal law itself must conform to certain principles of toleration. It must not encroach on freedom of *opinion* or of *cult*. That a misuse of that freedom transgressing certain limits must be prevented by penalties is recognised. Efforts to bring about a change of government must be permitted so long as they take the form of criticism and persuasion, even vituperation and declamation, but must be repressed if they extend to seditious incitement to violence or libellous attacks on individuals. Freedom of religion cannot be carried so far as to tolerate savage customs such as cannibalism, head-hunting, human sacrifice, ritual mutilations, sati, or thuggism. And freedom of religion itself requires that people should not wantonly say or do things which their neighbours regard as blasphemous or sacrilegious. Freedom is essential to artistic creation, but can hardly be so unrestrained that anything however offensive is allowed to be published or exhibited.

Even where the principles of freedom are genuinely accepted, difficulty is experienced in drawing the line beyond which freedom

must not trespass. But that is not primarily an economic matter. The criminal law is concerned with preventing actions, economic institutions with inducing them.

Competitivism is defended on the ground that let-do is *economic* freedom. But economic freedom is not so simple a matter as that. The division of labour necessitates discipline, and let-do does combine on the one side freedom of enterprise for anyone who can obtain control of capital and on the other freedom of contract for anyone who voluntarily submits to discipline. The trader is free to do what he likes with his own, and answers to no one for the activities of his enterprise, so long as he does not infringe the law. In the case of a company these privileges belong to the shareholders, but are in practice delegated by them to the directors.

The freedom of the trader is a reality, but it confers on him a power which may be used to limit the freedom of others. The great majority of people in a modern industrial community earn their incomes by working for employers. They work under contracts of service voluntarily entered into, but their only choice is between service for one employer and service for another. The conditions and the discipline are likely to be much the same. Personalities are different, and the freedom to choose whom to serve is not without its value. But that is only because conditions and discipline are to some extent dependent on the character and disposition of those imposing them. There is a certain degree of personal subjection to employers and their managers and foremen. This kind of limitation of freedom is inseparable from the division of labour. Organised effort must be subjected to singleness of direction and therefore to discipline, whatever arrangements may be made for its control.

Collectivism would substitute managers and foremen acting under what is ultimately State authority for those acting under private employers. The discipline would not necessarily be made less onerous, nor would appeals to official authorities necessarily evoke juster or more congenial decisions than negotiations with a profit-making industrialist or board of directors. And a change of employment would not in the last resort be a change of employer at all; the workman would be handed over from one State organisation to another.

7. Would trade unionism survive? The totalitarian State suppresses trade unionism or replaces it with a form of corporativism in which the workpeople's representatives are not freely elected but are appointed from above. They are allotted the duty of looking after the workpeople's interests, but that duty is always subject to their overriding responsibility to the Government which appointed them. If Fascism and National Socialism have sometimes proved attractive to the modern industrialist, that has been above all on account of their power of taming trade unionism. A totalitarian form of collectivist State

would inevitably follow the same course. And it is difficult to see how trade unionism can survive except in a very subordinate form in a collectivist State, even if it be democratically constituted. When the State is the sole employer, and competition is eradicated from the labour market, organised labour cannot bargain, it can only petition. Consultation with trade unions may be very helpful to the representatives of the State in making their decisions as to terms and conditions of employment. But the labour representatives can only be advocates or assessors, whereas the State representatives will be the judges. In case of dissent the trade unions can hardly be permitted to call a strike. A strike against profit-making employers puts pressure upon them by depriving them for the time of their profits. A strike against the State can only put pressure upon it by depriving the community of the products of the industry concerned. The profit-making employer holds out against his workmen because he believes that to give way would unduly diminish or perhaps extinguish his profits. The State holds out because what is offered to the workmen is what is estimated to be just and reasonable, and to give way would be to depart from that standard. Not that its decision is to be held irrevocable and beyond reconsideration. But any modification ought to be made on the merits of the case and not under pressure.

This relegation of organised labour to a consultative position would be more tolerable in a democratic community, where regular opportunities are given for making grievances heard, and pressure is applied in the political field. That political pressure itself may take undesirable forms is true, but that is part of the imperfection of human nature and occurs under all sorts of political institutions. Only in those that are not democratic it is rather more subterranean.

We see then that collectivism must destroy the freedom of collective bargaining. But collective bargaining is valued as a defence against exploitation and oppression, and if wages and conditions of labour are settled by State authority on judicial principles, no such defence ought to be needed.

The scales of pay in the collectivist State will not correspond with any exact assessment of the value of the services rendered. Not only will the salaries of those in positions of responsibility bear little relation to any valuation of their services, but even wages will not be tied down to that standard.

There will no longer be competition by employers in the labour market to force up the wages of those kinds of labour of which there is a shortage. A shortage of any form of skill will be met primarily by providing increased facilities for training. Only if the increased facilities fail to attract recruits will any concessions in regard to pay and prospects be offered. The concessions will be no more than are needed to stimulate the supply of labour; the demand for labour, as measured

by what it would be worth while for employers to pay under conditions of shortage, will not come into calculation. The free labour market deals with a shortage of any class of labour by raising its wages and limiting the demand for it to those employers who make a sufficiently profitable use of it to be able to afford the cost. The collectivist State allots the available workmen to the industries where they are most needed. The demand in terms of money for the products to which they contribute will be an important test but not necessarily the only one. And in any case it is not necessary to raise their wages in order to apply the test.

For the purpose of cost-accounting, it may be desirable to debit an industry with something more than the actual wage cost of any classes of labour of which there is a shortage. The true cost of such labour is to be measured by the value of the services it might have rendered in alternative employment. In fact there may be a scale of valuation of labour in cost-accounting entirely different from actual wages paid. Not only should the cost exceed the wages in cases of shortage, but it should be less than the wages for those forms of labour which are in course of being superseded or for any reason are in superfluity.

CHAPTER XX

FREEDOM AND ORIGINALITY UNDER COLLECTIVISM

1. COMPETITIVISM claims to give freedom of enterprise. Anyone is free to produce anything he pleases. It is taken for granted that this power will be used to produce what consumers demand. Anyone who intentionally produces otherwise than for sale at a profit is himself the 'consumer' so far as the deficiency is concerned. In principle therefore the freedom of enterprise is governed by the preferences of the consumer. In practice the consumer surrenders his initiative to the trader.

The freedom of the trader to devise anything he chooses that may please the consumer has great advantages. The prospect of high profits as the reward of success excites traders to activity of invention. The practice of creating demand by methods of publicity and suggestion is a drawback, in that traders can make a success of products which are not what consumers really need or care for. But with all its imperfections and its dependence on trial and error, let-do does give scope to the originality and initiative which are indispensable to progress in material welfare.

Would collectivism necessarily lose this advantage? To retain it, a stimulus as effective as profit-making has to be found for the introduction of innovations. Innovations involve risk, and private enterprise takes the risk for the sake of the big gain to be hoped for from success. The risk of loss attaching to innovations in a State-owned industry devolves on the State, and can only be incurred under due official authority. Where it is a question of changes of process which do not alter the product of an existing industry, or of changes of pattern which do not substantially alter the product, the responsibility can be delegated to those who are put in charge of the industry. They can be left to solve the technical problem of supplying the product which will best satisfy the consumers' need at the least possible real cost, and the loss arising from unsuccessful experiments in innovations can be debited (along with expenditure on research) as an overhead charge.

But innovations which involve the offer of new products carry a more incalculable risk. And when an innovation does not grow out of any existing industry, there is no one on whom the decision to try it or to reject it naturally devolves. If such innovations are to be given a fair chance, there must be some public organisation entrusted with the duty of considering them and providing capital for those projects that are sufficiently promising.

The private ownership of capital is the foundation of competitivism, and, if it is to be abandoned, the collectivist State must take over its

essential functions. Accumulation and capital outlay will both be in its hands, and it has to allocate these resources among competing purposes. There will be industries needing an extension of capacity to meet an expanding demand for their products, a 'widening' of capital. There will be openings for saving costs of production by installing new forms of labour-saving plant, a 'deepening' of capital. While the widening increases the demand for labour, the deepening diminishes it. If the widening were confined to increasing the output of existing products, it would eventually reach a limit; for one product after another demand would reach satiety, and, when all had reached their limit, widening would be confined to so much as would keep pace with the growth of population. Deepening would continue so long as technological progress provided new cost-saving devices, and reduction of cost might delay the satiety stage for some products. But the tendency would be for progress to materialise in more leisure rather than in more products.

That would not necessarily be an undesirable state of things. It might merely mean that material products were playing a proportionally smaller part in the aggregate of welfare, and that greater scope was left for the intangibles. But there is a strong presumption that fertility of invention and imagination in the sphere of material products will be closely associated with the qualities that contribute to the good life in other forms. Indeed it is hardly possible to draw a line between them. Creative products, ranging from beauty of form in what are primarily utility products, up to the material embodiments of the highest artistic or intellectual achievements, are inseparable from the imponderables of human intercourse. The apotheosis of pure thought, which has fascinated philosophers from time immemorial, is an abstraction. Only a very limited number of people with highly specialised qualifications can devote themselves to purely intellectual activities, and those activities, though perhaps commanding respect and even reverence, cannot fill a great part in the lives of the mass of people.

There is, it is true, a wide field of artistic creation in which the material aids employed, though essential, represent a minute proportion of the total of economic activity. Painters need colours, canvases, and other appliances, musicians need instruments, sculptors need materials and tools. The production of such things is a highly specialised field in which the initiative often lies as much with the artists themselves as with the expert producers.

But this section of artistic creation does not by itself provide variety and adornment in the things encountered by ordinary people in their daily life. Even were the things they use and handle and see well and attractively designed, there would still be something missing if they were not varied or if variations were within narrow and unimaginative limits. There is often some absurdity in changes of fashion,

when they are introduced by profit-making traders in order to hasten the obsolescence of the things of another fashion previously in use, and are accepted by consumers who like the newness of their possessions to be conspicuous. There may be little beauty in the new and much waste in discarding the old. Nevertheless change of fashion, within limits, is desirable in itself. Monotony is a form of ugliness, and excessive repetition may eventually degrade even a beautiful design. That does not mean that beautiful designs and desirable types once in use can properly be superseded and lost. But each new design evokes a new moment of artistic appreciation, and appreciation itself depends very much on contrast and comparison.

In order to give scope to originality and imagination, it is essential to assure freedom of opportunity to the individual. Those precious faculties cannot be driven; they must be allowed to work in their own way. The choice here is not between a competitivism which allows freedom and a collectivism which imposes organisation and discipline. Competitivism itself subjects design in industry to the decisions and the judgment of traders. Artistic talent does enjoy a measure of freedom, subject, as we saw in Chapter XIII (pp. 205–8), to the exigencies of a necessary maintenance, but the use made of it depends on the discrimination exercised by the traders. A trader who wants to adopt artistically good designs can get skilled assistance in selecting them. But so long as his primary aim is profit-making, it will be such designs as promote sales that he will look for. In a happily constituted world it would be always the best things that would sell best. But it often happens that the appreciation of the better things is an acquired taste, and that inferior things with superficial attractions, making an immediate appeal, get the preference. Traders are not always so bent on profit-making as to assess beauty of design or workmanship solely as assisting sales. Many will be found who aspire to produce things of well-founded merit, even if they thereby forgo a part of their opportunities of profit. Among these may even be some who pretend to no appreciation of artistic design on their own account, but who yet have faith in its value as contributing to the good life. Trading, however, is not a vocation which tends to select people with better appreciation than the mass of consumers, or with aspirations beyond profit-making, and, if there are some such among traders, that is just good luck.

2. The State-owned industries of collectivism, on the other hand, are in a position to aim avowedly at design and workmanship in advance of the appreciation of the mass of consumers. But if they are to attain this object, their organisation must be adapted to the essential conditions for doing so. Those in charge of the production and marketing of commodities must be imbued with a policy which is not content with profit-making on behalf of the State nor even with pleasing the con-

sumers. A free field must be assured to artistic talent. Probably that should mean that there would be some artists who live by selling their own products direct to those who care to acquire and possess them, others who sell designs to industry, others who make employment in industry a career, and yet others who are selected for endowment by the State. Thus there may be constituted an artistic community which will be, with some State assistance, in an independent and self-supporting position. In a collectivist community in which there are no rich profit-makers, but still a numerous middle class with moderate incomes, there may be a remunerative market in pictures, sculptures and other artistic products, so that an artist's success will not depend exclusively on official standards of taste.

And a very free discretion can be delegated to the individuals in charge of industry in the selection of designs. That discretion cannot be altogether dissociated from official standards. Here there is a very real difficulty. There must be some safeguard against vagaries, extravagances or blunders making a costly product repulsive or unsaleable, and yet the dead hand of the officially safe standard must not be allowed to suppress innovations which, though startling, contain genuine artistic vitality.

How is the State to obtain the services of really discerning critics? This seems at first sight a very subsidiary problem of collectivism, but it is in fact one of the most fundamental. An artistic community breeds critics, but unfortunately the critics are as individual as the artists. If critics are needed to adjudicate upon the artists, can super-critics be found to adjudicate upon the critics?

The solution is to be found in preserving as big an area of freedom as possible, not only for the artists but for the critics too, and trusting to the latent power of appreciation in human nature ultimately to select the better and reject the worse.

The foregoing observations apply primarily to the plastic and decorative arts. But the same questions, along with others, arise in relation to drama, music, literature, learning and science, to education, culture and entertainment, to freedom of speech and publication.

Where a creative product is dependent on an expensive organisation, competitivism relies on an uneasy alliance between the trader and the artist. Dramatist, producer and actors depend on the promoter of theatrical enterprise; in music the composer and the performers depend on the promoters of concerts and owners of concert halls; literature and the publication of learning, science, news and opinion depend on printing and publishing enterprise. In this sphere the trader is not merely concerned with a creative aspect as a subsidiary part of his product; the product itself is of the creative type. The predominance of profit-making is a good deal modified by the entry into the business of people who combine the command of capital resources

with genuine artistic appreciation and ambitions. The successful traders in entertainment are those who exploit popular tastes on a large scale. Inevitably they interfere in many ways with more modest enterprises which offer entertainment to a more select public, and in some conditions crowd them out altogether, by gaining control of theatres and halls and the equipment, organisation, skilled services, and the means of publicity. Actors, musicians, authors and composers who want to make use of these facilities must conform to the conditions which those who control them choose to exact. But there are enlightened capitalists who enter the business with some better aspirations than profit-making, and whose ambitions will not be satisfied unless they can claim to have made artistic as well as commercial successes. Among them is now and then to be found a wealthy philanthropist who abjures calculations of profit and loss and treats his private fortune as the endowment of his enterprise. More often the capitalist compromises between his artistic and profit-making motives, making some concessions to popular fancies, and giving up part of the gain realised on them to productions of a more limited appeal.

And it would be a mistake to pillory popular taste as wholly unenlightened and inappreciative. Very much in art, whether embodied in entertainment or in other forms, is a matter of acquired tastes, and the perceptive powers from which these acquired tastes proceed are not rare or exceptional. In the ideal world of competitivism, the paramount motive of the purveyor of entertainment would be to make a profit by evoking these acquired tastes. But in practice this is the ambition of a few, and the easy path of exploiting existing crude fancies predominates.

Room is found, it is true, for ventures, such as repertory theatres and musical societies, which depend on assured subscriptions from a limited circle of appreciative supporters, collected rather by personal association than by systematic publicity, very likely assisted by the guarantee of one or two rich patrons. But any departure from sheer profit-making is a departure from the strict doctrine of competitivism.

Collectivism can no more tolerate profit-making in entertainment than in any other business. When the swollen gains of profit-making are being eradicated from trade and industry, their continuance in one limited field would be too flagrant an anomaly to be thought of. The small-scale dramatic or musical society could be allowed, if so constituted as to exclude private profit. But the main entertainment industry would be in the hands of the State.

Here, as in other fields, the State cannot ignore demand. It cannot go on organising entertainments which no one comes to and which entertain no one. But it is free to take account of the cultural value of the entertainments it offers. It need not be tempted to degrade a production in order to attract additional receipts from a less dis-

criminating stratum of the population. That all classes and all cultural levels should have adequate opportunities of enjoying entertainment is right. But that the more sensitive and discriminating should be deprived of the kind of entertainment that suits them, because cruder tastes have to be appealed to to swell the receipts, would be deplorable. And even the cruder tastes need not be too abjectly courted. It has been shown over and over again that entertainment of very real artistic merit can appeal to the multitude, and indeed that every great popular success must have some artistic qualities, even if these be combined with outrageous vulgarity or sentimentality or sensationalism.

A dissociation of entertainment from profit-making might be a real gain. On the other hand, the danger is only too apparent that the displacement of private enterprise by the State may mean stagnation and an extinction of originality and imagination. If that disaster is to be avoided, collectivism must somehow preserve freedom for the artist in music and drama. A genuine understanding of the need should lead to a selection of enterprising individuals of artistic discernment to administer the entertainment industry, with a wide discretion to give facilities for any promising innovation.

If alongside the main industry generous facilities are given to the small-scale non-profit-making enterprises, so that they can hire suitable accommodation and can get necessary equipment made to their specification, and perhaps even borrow capital from the State, it may be that a collectivist community can confer more real freedom on drama, ballet and music than one that remains competitivist. But this freedom will not come of itself. Unless care is taken to establish and maintain the conditions that will safeguard it, official regimentation will prevail, and with it unimaginative caution and stagnation.

3. The present century has seen the introduction of two inventions which have revolutionised the entertainment industry, and have raised the problems of profit-making in an acute and urgent form. The exploitation of moving pictures has evolved a vast organisation commanding not only commensurate resources, but a complexity of restrictive contracts and performing rights, calculated to secure far-reaching control. The cinema industry is essentially one supplying entertainment to the multitude, and, in order to gain profits commensurate with its huge costs, it must seek to attract all. It has blatantly applied itself to the mass-production of entertainment for the mass. In so doing it has illustrated in a striking manner the necessity of certain qualities, by no means wholly divorced from art, for the attainment of popular success. The successful cinema production has its excellences, even if in many respects it is degraded by commercialism.

Wireless broadcasting has raised rather different problems. If it is left to private enterprise, broadcasting has no such simple channel

of profit-making as the sale of seats in the cinema. One principal source of profit is on the sale of the receiving sets. But the value of a receiving set to its possessor depends on the attractiveness of the broadcasting programmes. It is to the interest of the producers of the apparatus that there should be attractive programmes within everyone's reach. But whoever supplies a programme supplies it to all listeners alike, from whatever makers they get their apparatus.

The monopolistic provision of programmes by a combination of the manufacturers of apparatus is not the only solution. For an attractive broadcasting programme is a very valuable medium of publicity, and wealthy commercial concerns are willing to buy time in a programme and to occupy it with something attractive to listeners in combination with the desired advertisement of their products. The mixture is not very satisfactory to listeners. It is not desirable to subordinate the selection of entertainment to the advertising purpose, and the interruption of the entertainment by the intrusion of the advertising matter is unwelcome. Moreover broadcasting is so effective a method of publicity that its employment is a matter of public policy. Consequently in some countries broadcasting has been made a State monopoly, the programmes being financed by a licence fee on receiving sets.

The British Broadcasting Corporation is a notable example. That is a departure from the principles of competitivism. It differs from the recognised exceptions, classed as public utilities, in that it is for the supply of a creative product. The public or publicly controlled enterprises which supply transport, communications, gas, electricity, water and sanitation do not have to exercise artistic imagination or taste.[1]

The State operation of broadcasting has produced tolerably satisfactory results. It has escaped the special faults of the commercialised cinema. But it is not by itself an adequate test of State-produced entertainment, since it has had the products of private enterprise in music, drama, literature and news service to draw upon. And its experience has brought out the difficulties of a public monopoly in exercising impartiality among the claims of artists, performers, speakers and authors to be given opportunities. The commercial purveyor of entertainment, being responsible to no one for his selection, can exercise his preferences, whether on commercial, artistic or merely personal grounds, without any pretence of treating rival applicants impartially. Where there is no monopoly, claims rejected by one may be accepted by another.

The advantage in this respect is not wholly on the side of private enterprise. The irresponsibility of private enterprise may often lead in effect to an unfair exclusion or discrimination against individuals or movements that excite adverse prejudices. And private enterprise

[1] But it may be very desirable that they should, so far as they use things susceptible of design.

in entertainment is sure to give rise to some partial monopolies. The avowed monopoly of a State enterprise can at any rate be regulated by an injunction to be impartial. The danger is that the impartiality may take the form of a mechanical application of conventional standards, tolerating all those vagaries and extravagances that the public are familiar with, to the exclusion of anything so new as to be difficult to understand, as the police tolerate in park orators any form of atheism, anarchism, or revolutionary sentiment that they know, but would be suspicious of any doctrine bearing no familiar label.

4. Broadcasting itself raises questions of freedom of opinion and of speech, as well as of artistic freedom. And here collectivism is faced with difficult problems. Broadcasting is an alternative to printing as a means of publication. With printing it shares the characteristic of being able to convey a communication to millions of people.

Broadcasting is a new-comer, and the problems of publication are best considered in relation primarily to the business as it has been established and matured on the basis of printing. Competitivism has evolved two great branches of the publishing business, book publishing and the newspaper trade.

Book publishing is one of the more successful applications of competitivism. Entry into it can be gained by a new man with moderate capital, and there are some among those it attracts who have genuine literary tastes and discrimination. It comprises every variety of combination of profit-making commercialism with enlightenment. The new and unknown author often has to meet many refusals before he finds a publisher who will bring out his work. But on the whole it is probably true that works of any real merit can nearly always get published. Apart from a few works of art or learning of limited appeal, which probably have to depend on educational endowments, learned societies, or the authors' own resources for the means of publication, saleability necessarily remains the test. But nearly all works of merit may be expected to sell enough to yield some profit. Circulating libraries, securing great numbers of readers who would not spare money to buy the books, help to steady the demand.

The publishing business is based on monopolies established by the law of copyright. But, though each book is separately a monopoly, books and publishers and authors compete with one another, and the publishing trade does not take more than its share in the abuses of profit-making. Now and then a 'best seller' yields a rich haul to both publisher and author, but book publishers have never taken a prominent place in big business.

Marked is the contrast presented by the newspaper trade. A daily newspaper (or a cheap Sunday newspaper) under modern conditions is a big enterprise. It not only sells news to the people who buy and read it, but it sells publicity to those who advertise in it. Economy of

production requires a considerable circulation in any case for the former purpose, but for the latter the wider the circulation the more valuable is the publicity. Newspapers are therefore tempted to go a long way beyond the mere supply of news in order to attract a wider public and increase their circulation. They add a third function to the other two and become media of entertainment, supplying every kind of light reading and serious instruction, to attract readers who care little for the news.

Publicity is a trade in which it is especially true that to him that hath shall be given. The greater the circulation of a newspaper, the greater is the demand for advertising space in it, and the higher can its charges be. And the greater its receipts from this source the better service it can offer its readers. It can develop a more efficient and comprehensive news organisation, and provide more attractive features. Thereby it gets all the greater advantage in extending its circulation. The big and successful newspapers crowd out the little ones. Even where a paper has characteristics that are greatly preferred by a section of the public, it cannot survive unless it can attain a circulation big enough to make its publicity valuable.

The result is a concentration of the newspaper business in the hands of a small number of big concerns. Now a vital condition of the working of democracy is freedom of opinion, and especially freedom of opinion about current events of political significance. Newspapers exercise great power over the formation of opinion, not only by their comments but still more by their selection and presentation of the news itself. Every trading concern tends to come into the control of two or three individuals or often only a single one, skilled in profit-making and entrusted on that account by the shareholders or proprietors with plenary discretion. That happens in the newspaper trade as much as in any other. Great power of influencing opinion is placed in the hands of a few men who have gained their position not for any wisdom or virtue in exercising that power, but for their capacity in directing a big publicity organisation.

The directors of a newspaper, it is true, do, if they are wise, give very free discretion to the editor. But he is selected by them, and the policy to be followed is formulated by them. The directors may indeed repose so great a trust in the editor as a profit-maker that they leave the policy to him. In that case it is he who has the power. The danger of an undesirable use of it remains. Editors are more likely than the promoters of commercial enterprises to have the faculties for an intelligent use of the power, but the danger is in some aspects all the greater for that. Profit-making pure and simple exhibits a splendid impartiality among competing opinions or causes. It aims at providing what the public wants, and any resulting bias is accidental. An active editor is likely to have views and prejudices of his own, and, if the

principal organs of news and publicity are in the control of a very small number of them, undue weight is given to their individual views.

Formerly freedom of opinion meant just the absence of a censorship and of repressive laws or practices discriminating against any particular opinions. The revival of repression, blatant and unashamed, under totalitarian dictatorships has unhappily brought this once again into the field of controversy. But freedom of opinion is also exposed to a flank attack from the use of economic power to discriminate positively in favour of some opinions and against others.

That was already felt in the nineteenth century. Among the advantages which wealth conferred on a party in the working of a democracy was a preponderant control of the newspaper press. So long as parties were not divided on the issues of wealth and class, there was no pronounced advantage in this respect on either side. The resources of a land-owning conservative party and an industrial and commercial liberal party were not ill balanced. But when both land and capital feared attack and rallied to one party, they gained a disproportionate representation in the press. It is not merely that newspaper proprietors are drawn from the wealth-owning classes, but the circulation of a newspaper among wealthy people adds to the value of its publicity. The improvement of the standard of living of the mass of people and the extension of education have diminished this advantage in the present century, in that a newspaper may gain success through a circulation extending far outside the well-to-do classes. Political partisanship has become much less pronounced in the big newspapers. On the other hand, the concentration of the control of the newspaper press in the hands of a few wealthy men remains a danger.

5. Collectivism would sweep away profit-making in newspapers as in all other enterprises. But State ownership of the means of publication would raise the problem of freedom of opinion in an acute form. Freedom of opinion is not only of the highest importance in the fields of science, learning, philosophy and art, but is essential to democracy. If the State monopolises the means of publication, how is it to maintain impartiality among rival opinions, and particularly in tolerating those critical of itself?

To that question there is no simple or complete answer. The collectivist State has in fact the power of controlling the publication of opinion, and can, if those exercising the power so choose, prevent the expression of any views unwelcome to it.

On the other hand, that is equally true of the repression of opinion. The competitivist State has the power of intolerant repression, and if it refrains from exercising the power, that is because those in control of it have adopted a policy of toleration and freedom. A collectivist State might be similarly guided in the exercise of its monopoly of publication.

The monopoly is primarily of the mechanical means of publication. The printing, binding and distributing organisations, which under competitivism would be profit-making, are State-owned. Publishing is a form of enterprise distinct from these. At the same time, if publishing is to be allowed to survive under conditions of private enterprise in a collectivist State, publishers and authors must somehow be precluded from profit-making on an illegitimate scale, that is to say, on a scale yielding them larger individual incomes than public policy allows. If there are people who have money and are willing to use it in the production of books, they need not be prevented from doing so, but if they put the books on sale they must somehow or other be made to account for the proceeds and restrained from appropriating more than a limited amount of profit for their own use. The individual would not be allowed to draw from the business more than would bring up his income from all sources to a prescribed maximum. The rest of the profit could perhaps be treated as reinvested in the business, and available both for covering losses and for extending enterprise. But the extension of any privately owned profit-making business that is tolerated in a collectivist community must be subject to limitations. For example, a publishing business which so expanded as to employ more than a certain number of people might be taken over by the State.

The independent publishers would not necessarily be confined to those using their own and their associates' private resources. In suitable cases the State itself might advance funds and take risks, or assume probable losses. But the State would also itself initiate publishing business on a large scale. In the publication of books, as in the production of other creative products, the aim ought to be to delegate a very free discretion to competent directors and managers. In order to assure variety and flexibility, the business ought to be decentralised. It would be better that there should be many separate State-owned publishing businesses and the head of each should receive authority direct from the State, than that all should be comprised in one vast organisation working under a departmental hierarchy.

Authors' royalties are a form of profit-making, and the popular author, whether his works were published by the State or by a free publisher, would have to be subjected to an income limitation. His excess gains might be credited to him for certain purposes, not only to level up his income in future unfavourable periods, but for meritorious objects such as undertaking or assisting literary or artistic enterprises which were not expected to cover costs. But what was not required for permitted purposes would lapse to the State.

In principle the same treatment would be appropriate to the newspaper press as to book publishing. There might be no possibility of promoting a newspaper enterprise with capital privately subscribed in a community where there are no large fortunes. Weekly or monthly

periodicals presenting not news but comments on current happenings and movements might find a place, but newspapers depending on a wide circulation would inevitably be State-owned. There should be a number of separate State-owned newspapers, each in the hands of a chief with a very wide and free discretion. The directors and editors should be appointed primarily for their competence, but the desirability of giving adequate representation to various points of view should also be taken into account. Sales should be one test but not the only test of success. An editor who attained a high standard of merit but only a moderate circulation should be upheld, and one who attained a vast circulation by mean vulgarity and sensationalism should be frowned upon.

If freedom of opinion is a policy deliberately adopted by a collectivist State, how can that policy best be put into effect?

There must presumably be a department of the Executive Government responsible for the production and distribution of publications. It will appoint the directorates of all the State-owned publishing concerns and newspapers, and will formulate the policy to be followed. The policy will presumably be to offer facilities for publication to all comers subject only to the condition that those works which are not expected to be remunerative must be subject to some test of merit. In practice freedom of opinion will depend even more on the appointments than on the formulation of policy. It is only too easy for an official body to adopt phrases enjoining freedom, yet without a genuine spirit of freedom its practice will go awry.

Even a democratic competitivist State enjoying a high-sounding constitution may be deplorably unfree if its people, legislators, ministers and employers, do not understand freedom. A collectivist State where the people really care for freedom, even one with a constitution not ostensibly democratic, may in practice secure a high degree of freedom, not only in artistic, literary and scientific creation but in the expression of opinion, though undoubtedly people who care for freedom are likely to insist on democratic institutions to maintain it.

Totalitarianism negates freedom, not only in repressing all parties and bodies of organised opinion other than its own, but in resorting to intensive propaganda in favour of its own principles and its own authority. If a collectivist State is to secure freedom, it must not only give as free a hand as possible to those in charge of publication and publicity, subject only to the essential prohibition of the criminal law, but it must abjure officially supported propaganda. It is not always easy to draw the line. Much of what Governments have to do requires a great deal of explanation to enable the public to co-operate, and it may be difficult to distinguish between elucidation and advocacy. Here again it is the spirit that matters.

6. There is one vital sphere in which the problem of positive Govern-

ment influence on opinion has long been a political issue. That is education.

Education supplies the greatest of all creative products; it forms the man himself. For it mankind depends primarily not on marketable services but on the elemental obligations of the family. So complex, however, are the requirements of civilised society that the parents' care has to be supplemented by the work of paid professional educators.

In the middle ages this work, so far as it was done at all, was done by the Church. The Church had a monopoly of learning, and very little was thought necessary or appropriate for a layman, even for one destined to fill a responsible position in the community. The Renaissance brought new standards of culture for the laity, but up to the nineteenth century the profession of education in Europe was almost entirely in the hands of the Churches. Since the Reformation there had been rival religious bodies, some enjoying the status of establishment, with historic endowments, others tolerated as voluntary associations, depending on their own resources. But they were far from covering the whole ground.

Democracy engendered the idea of education as a service publicly organised available to the entire population and detached from any religious body or movement. But even in 1848 the Communist Manifesto struck an apologetic note in advocating the provision of universal education by the State, and had to disavow any intention of subverting or superseding the family.

State-aided education was the first extension of the social services beyond the limits of poor relief. And State-aided education soon grew into State-provided education. In the heyday of competitivism the State found itself saddled with the anxious responsibility of supplying this greatest of all creative products.

The teacher is the parent's deputy, and a privately owned school has to conform to the parent's views. It may indeed go a long way beyond any educational plan that parents who are not educational experts could devise, but still the parents are at hand as searching critics, very much alive to the pattern in which their children are being moulded. Education of the type sought after by the middle classes, aiming at individual care suited to each pupil's idiosyncrasies, is expensive. Parents pay high for it, and it may be that they often fail to get what they pay for. But State-provided education does not even aim at that standard. Its purpose is to ensure that no child fails to get an education conforming at least to a prescribed standard, but the prescribed standard cannot be fixed very high, and is frankly regarded as a minimum. That is not entirely due to considerations of expense. If intensive education is expensive, that is largely because it requires a relatively high proportion of teachers to the number of pupils, and it may be difficult to recruit a sufficient number of people qualified to teach, even when expense is not made an

obstacle. When the introduction of universal education has meant a great and sudden enlargement of the educational system, it has inevitably been found necessary to establish a State-provided system of training teachers. But even that can only expand the supply of qualified teachers gradually. A sudden transition from a minimum standard to intensive education might require a doubling of the number of teachers employed, an extension unattainable except by such a dilution of the teaching staff as would partly defeat the object of the reform.

How would collectivism deal with the problem of education ? It would suppress profit-making, but it would not necessarily suppress all privately owned schools. It could tolerate them on the basis I have suggested above (p. 322) for publishers, and might let buildings on lease or even advance money to associations of people formed, on a basis precluding profit, for educational purposes. If there are to be moderate incomes of the middle-class grade, there is likely to be a demand from the recipients of such incomes for opportunities to devote their money to obtaining an education for their children superior to the State-provided minimum.

To such a demand there may be opposition on the ground that the educational advantages conferred will become the cause of a class distinction. The equalitarianism of democracy originated in an assault on hereditary privilege. The aristocracies that the eighteenth century had inherited from the middle ages were a class built up on inherited wealth and rank. The profit-making burgessry which succeeded them could dispense with rank so long as they could fortify their position with the advantages wealth could bring. Against them equalitarianism presses the claim for equality of opportunity. Equality of opportunity will allow the better men to get better positions, but, if they are thereby enabled to give their children better advantages, equality of opportunity is infringed.

But surely in an imperfect world a pedantic adherence to equality of opportunity is an impossibility. It is an inestimable advantage for children to have wise and good parents. The selection of a good school is only one manifestation of their wisdom. To admit inequality of incomes, and then to prevent the wise parent who possesses a sufficient income from making a special provision for the education of his children, would violate the deepest instincts of the family and provoke inappeasable opposition. It is true that even in a collectivist community, where money-making out of profit has been suppressed, the higher incomes are not necessarily associated with greater wisdom in parenthood or in other matters outside the services for which the incomes are paid. But the principal justification for tolerating inequality of incomes is to give scope for experimenting in the good life. Education is a vital part of the experimenting.

If education ranked as a department of applied science, like

agriculture or engineering, experimenting through voluntary enterprise on a system of trial and error would not be necessary. The experimenting would be undertaken systematically by the State, and its results applied throughout the State-provided educational organisation to the equal benefit of all. But education is a department rather of philosophy than of science. The ends of education are the ends of life. And even for a given end the methods of nurture and instruction are obscure.

Experimenting in education is not to be understood as meaning the starting now and then of a freak school embodying some new theory, but rather a perpetual testing of variations of method and variations of the practical ideal set up as the end. The good is infinite, and new approaches to it are always possible.

The State itself ought to engage on experiments in education. But here, as in art, literature, learning and entertainment, what is wanted is free play for the creative spirit. That is not easily ensured under official regimentation. If a collectivist community is to be redeemed from fatty degeneration of the spirit, the most hopeful way of escape will be through the encouragement of voluntary associations, precluded from profit-making, for all sorts of creative purposes.

With educational policy in the collectivist State is closely related the question of appointments. How are candidates to be selected for the posts which are sought after as offering the best prospects of a career? Fitness for the professions and for responsible administrative posts demands not only adequate natural capacity but a liberal education. That usually means the prolongation of education to the age of twenty-one or more at a university, and for some of the professions a liberal education has to be combined with specialised study to a later age still. A few exceptional individuals can make opportunities for themselves, but in the main the selection of people to become eligible for these careers will be made at the age at which it is decided whether they are to go to a university.

Among ambitious parents who believe their children can get advantage from a university education, those who have substantial incomes are free to act on their belief. The children of those who cannot afford the expense may be given assistance by the State, but must presumably be subjected to some independent test of capacity and fitness. The resources of the community and the standard of living might be such that the whole population could receive a university education. But it is probably only a minority that can benefit by it. Most young people at the age when university education begins would be rightly impatient to have done with study and to engage in practical life.

The future may see an educational revolution. It might, for example, be found both practicable and desirable to extend the years

of education for everyone up to the age at which a university course is completed. But that has no special relevance to collectivism. If desirable at all, it is consistent with a competitivism in which education has already become a recognised exception to the rule of let-do.

Given the educational system we have, the differentiation between those who have and those who have not the liberal education which is completed at the university will remain. The differentiation begins in early years. Parents who destine their children for the university, and for a career for which a university education is of value, will plan their education for that object almost from the beginning.

The doctrine of equality of opportunity would require that the selection should be made according to the fitness of the child, not according to the income of the parent. Collectivism is not necessarily bound to push equality of opportunity to its logical conclusion. But in virtue of its responsibility for making appointments the collectivist State is more directly concerned than the Government of a competitivist community with the selection of individuals to receive a liberal education. To let the selection be determined by parents' choice and therefore in practice mainly by income is to invite the growth of a governing class.

To widen the selection, what is wanted is a reliable test of fitness to be applied to children at an appropriate age and, subject to further siftings from time to time during the school course, an award of scholarships or bursaries of sufficient amount to maintain those ultimately nominated for their full time at a university. Only so could the appointments of high prospects be opened to all classes.

That mode of proceeding presupposes that a reliable test of ultimate fitness can be found in the early years. There is always a danger that such tests may degenerate into examinations of the conventional type. Within limits examinations fulfil a useful purpose, but they are not adequate for distinguishing the faculties and gifts needed for future executive and professional responsibilities.

CHAPTER XXI

MONEY AND EMPLOYMENT UNDER COLLECTIVISM

1. It may be that competitivism will be discarded in favour of collectivism, not primarily for the purpose of getting rid of profit-making, but as a refuge from unemployment and the breakdown of the monetary system and of international trade. How far can it really promise a refuge?

General unemployment is caused by a contraction in the flow of money. Under competitivism that has been the result of restrictive measures intentionally applied to the credit system, usually as the sequel to an excessive expansion in the flow of money being allowed to develop. It cannot be taken for granted that the same thing will not happen under collectivism.

Collectivism sweeps away the mechanism of bank advances by which the competitivist credit system regulates the flow of money. The greater part of the population being employed by the State, their incomes, which are paid by the State, are the source of the greater part of the flow of money. The services rendered to the State, for which these incomes are paid, are embodied in all the products which the State supplies, the consumable goods put on sale, the instrumental goods which remain its property, and the administrative services which under competitivism would be paid for out of the tax revenue. The State receives back so much of the money it pays out as the recipients spend on the consumable goods produced by the State. We have been assuming that some production is still left to private enterprise, and there is still some taxation, at any rate for providing local authorities with a revenue. But the people deriving their incomes from these sources will themselves spend money on State-produced goods. In fact the difference (if any) between the amount of money paid out by the State in any interval of time and the amount it receives back will be the increase or decrease in the amount of money held in balances by the entire population. That is so because the State is the sole source of money. The money takes the form either of currency issued by the State, or of credit balances with a State banking institution. In either case it is practically a debt due from the State to the holder, a debt which is extinguished when the holder buys something from the State.

The outstanding balances, constituting the unspent margin, are the result of the free disposition of the holders. They decide at their discretion how much they will spend and how much they will accumulate unspent.

The State will aim at disposing of all its products. It will be un-

willing to accumulate unsold stocks of goods beyond what is judged to be an advisable margin or working balance of each commodity. When the sales of any commodity flag, there are two ways of avoiding the accumulation of a redundant surplus; one is to reduce production, the other is to stimulate sales. The deficiency of sales may be due to want of publicity, and the remedy may be found in additional advertisement. The amount of advertisement that public policy will allow will be limited, and if the limit is reached, the choice is between a reduction of price and a reduction of output. Under competitivism the trader usually gives the preference to a reduction of price, and, rather than reduce output, gives up a part or the whole of his profit or even produces at a loss, not receiving a sufficient margin over prime costs to cover his overhead expenses. Under collectivism the same considerations will apply. A State-owned industry can act as a unit. It can be directed to produce up to capacity or to curtail production to any desired extent. But so long as the productive resources organised in the industry remain in being, under-employment of the industry is wasteful. The State can afford to take a wider view than the private employer. It can take its pricing policy for all products as a whole, and can sell some goods at a loss, possibly even receiving less than prime costs if that seems desirable. It can therefore aim at so fixing the prices charged to consumers that every commodity will be disposed of.

There will sometimes be products for which the demand so falls off or for which the output has been by a miscalculation so enlarged that the whole output cannot be disposed of; the demand at any price, however low, even at a gratuitous distribution, falls short of the output. Of such the output must be restricted, and unless the failure of demand is due to a temporary cause, the productive resources of the industry concerned will have to be definitively curtailed.

In a less extreme case an industry can dispose of its entire output so long as it sells at a low price. But if the deficiency of demand is thought to be permanent, and if there is no ground of policy for continuing to supply the product on terms which amount to subsidising the consumption of it, here also the productive capacity of the industry will have to be curtailed.

The equalisation of output and demand is a requirement of consumable goods. Instrumental goods are produced by the collectivist State for itself to own and to use. The State pays wages and salaries for all productive operations and all services rendered to it, while the consumers' outlay is expended on a part only of the output. The rest of the output represents primarily the profit in the receipt of which the State has superseded the profit-making trader. Primarily, but not exclusively, for if the people retain a part of their incomes unspent, the money is deposited with the State as the banker. The goods supplied to

consumers will be equal not to the whole of their incomes but to the part that they spend, and the margin of production retained by the State will be so much the greater. This additional margin is not covered by the State's profits, but by its additional *indebtedness* in its capacity as banker and issuer of currency.

The whole of the individual savings need not be in the forms of currency and bank credit; inducements may be offered to tie up savings in long-term or medium-term loans to the State, or in life insurance or life annuities. But people will want to hold adequate balances of money, and, in a society in which there are no big fortunes and no opportunities for investment in lucrative shares, these balances are likely to form a considerable proportion of the total.

So long as savings form a fairly constant proportion of the consumers' income, there is no great difficulty in equalising output and sales of consumable goods. There will be transfers of demand from some products to others, and difficult decisions may be called for as to the time, manner and extent of the corresponding transfers of productive capacity. But, general demand being steady, productive resources released in one direction will be needed in another.

If, however, the proportion of income saved increases or decreases, the demand for consumable goods decreases or increases. The disbursement of balances may for a limited period make saving a negative quantity, consumption exceeding output. Or an increase of saving may result in a shrinkage of sales of consumable goods, and an accumulation of unsold stocks.

Thus there may occur just such a shrinkage in the flow of money as under competitivist conditions causes general unemployment.

If the shrinkage of demand is believed to be merely temporary, industry may go on producing consumable goods for stock in the expectation that they will be readily sold off when demand revives. But that is to assume not merely that demand will revive, but that the previous arrears of demand will be overtaken, that is to say, that the excess savings will presently be dissipated and added to current expenditure on consumption.

That would be a very unsafe assumption. But if production is to be curtailed, there will be under-employment of both plant and labour. That means loss and waste, and, however generously the unemployed are treated, a feeling of frustration and discouragement on the part of those whose skill and faculties are thrown out of use.

The collectivist State might adopt the public works policy which has been so insistently recommended, and expand its capital outlay so as to use up the productive resources released. But that is not easily put into practice. Capital outlay takes a lot of planning, and, if plans are made in anticipation of needs, they need so much revision that the delay is hardly less than with new plans. If capital outlay is carried

out in advance of the needs it is to meet, the completed work is liable to be found ill adapted to its purpose. Moreover the transfer of productive resources from one set of industries to another (from the consumption industries to the instrumental) is not easily effected. New plant may be required, and labour has to be put in training.

2. A more satisfactory solution is to be found in an adjustment of *prices* to the change in demand. If prices are reduced, while incomes remain unchanged, people can save more without cutting down their consumption. Those who do not care to save can increase their consumption; those who do can save more with less effort. And similarly, when saving falls off, and demand expands, a rise of prices will diminish the equivalent in goods of a given expenditure of money, so that the demand can be met without a proportional increase in output.

But it must not be taken for granted that an adjustment by means of prices is simple and automatic. If consumption is approaching satiety, a reduction of prices may give it little stimulus. People may save more and more merely because they have no need to spend more, so that the collectivist State finds its accumulation being effected to a great extent by an ever-growing indebtedness instead of out of its profits. In an age of plenty, if the burden of armaments is limited, that is a possibility. Satiety, however, is relative. It may be that demand can be excited afresh by the invention of new products. But invention cannot be counted on at the State's bidding. If consumption remains extremely unresponsive to any stimulus, and there is no reason to expect its early revival, the appropriate remedy is a reduction of working hours. It is indeed folly to keep people at work producing things they do not need. Increased leisure is a precious contribution towards the good life.

That is on the assumption that the work devoted to accumulation and to the functions of government (administration, defence, etc.) is what policy regards as desirable. Accumulation itself is required partly for enlarging the community's productive capacity, and, when consumption approaches satiety, enlargement also approaches its limit.

As a deficiency of demand for consumable goods can be met by a reduction of prices, so can an excess be met by a rise of prices. If the productive resources of the community are fully employed, and the proportion devoted to accumulation has been determined at that which policy indicates as desirable, the alternative of an increase of production is not available (except by way of a revision of the standard of leisure and of the meaning of full employment).

The existence of savings in the form of loose money makes possible a temporary expansion of demand far above output. If the extra demand can be finally met from stocks of goods, no other measure is immediately necessary. The amount of the extra demand is limited only by the amount of balances in the consumers' hands, and it may be

enough to make a greater inroad on stocks of goods than prudence can allow, and even to exhaust the stocks of some kinds altogether. That can be prevented by a sufficient rise of prices.

But the rise of prices will not be acquiesced in without protest. One who has saved for a purpose will not be pleased to find that after all he has not saved enough, because, just when accomplishment seems to be within reach, prices have been raised against him. One who does not save has no margin to draw on to maintain his standard of consumption when he finds the purchasing power of his income diminished. If the available balances are very large, prices may have to be raised very high, and especially so if the public are seized with the fear that prices are going to be raised higher still. A situation might come about quite intolerable to those who have no available savings, and little less so to those who have.

The phase of excess expenditure will come to an end, at any rate when the loose savings have been used up. By that time stocks of goods will have been heavily drawn upon, and, to reconstitute them, production of consumable goods must for a time exceed consumption. Prices will therefore have to be kept above their normal relation to incomes. When the reconstitution of stocks has been completed, prices can be lowered again. But by that time accumulated savings will have been greatly reduced, and the principal effect of the reduction of prices is likely to be a revival of saving rather than of consumption.

3. Collectivism thus does not get rid of the embarrassments inherent in the freedom with which money endows the consumer to choose the *time* at which he brings his income to fruition in expenditure. Not less than competitivism, it has to adjust its plans to the consumers' vagaries. Adjustment can never be perfect or instantaneous. Every new phase requires a period of trial to determine its character and extent, and especially to discover whether it is permanent or temporary. Miscalculation or delay in action may result in a large excess or deficiency of stocks, necessitating a price level below or above normal to correct it. A rise of prices might, it is true, be modified by the application of a rationing system to limit consumption. But a rationing system cannot cover the whole ground, and it is in any case a vexatious expedient, and not very appropriate in a community where there are no great inequalities of income.

Advocates of collectivism have sometimes included an abandonment of money in their plan. The acceptance of extravagant inflation in the early days of Russian communism was regarded as a prelude to the complete suppression of money. But complete suppression was never found practicable.

The use of a monetary unit of account for the reckoning of incomes and prices may be assumed to be indispensable. But what is embarrassing and possibly dangerous is the accumulation of unspent money.

Various devices might be resorted to to keep the accumulation of money within limits. Investment in the familiar form of long-dated or funded national debt would offer a solution, provided that people can be induced so to invest a sufficiently high proportion of their savings, and that they cannot too easily turn the investments back into money. Fulfilment of the latter condition is readily within the State's power. So long as, in its capacity as the sole banker, it refuses to facilitate the sale of securities by making advances to the purchasers, the seller only increases his money to the extent that the purchaser decreases his. But the mere fact that it may be difficult to sell securities would deter people from investing in them, even though a liberal rate of interest were offered. Limitations might be placed on the liquidity of bank deposits, all in excess of a moderate individual limit being made subject to long notice or compulsorily invested. But that would be ineffective unless the hoarding of paper currency were prevented.

Proposals have been made at times (for instance, by Silvio Gesell) for making the holding of paper currency subject to a deterrent charge. The device of requiring a stamp representing a small percentage of a currency note's value to be affixed to it at stated intervals of time to preserve its validity as a medium of payment, is vexatious and troublesome. But people could be deterred from holding notes in preference to bank credit, if a small charge were made on the first issue of a note and every issue were valid only for a limited period of, say, a year, on the expiry of which it would have to be paid back into a bank to escape being deprived of value by demonetisation.

Rules of this kind would not be very popular, but might be advisable if the smooth working of the monetary system were endangered by unmanageable accumulations of loose money. Facilities could still be given for paying off funded debt to a holder who could show a special need for money.

The device of perishable money would enable a collectivist community to reconcile an abolition of interest, if desired, with a continuance of long-term lending to the State. For bank credit on current account could be made subject to a charge, a kind of 'negative interest,' and a loan tied up for a term of years be free of charge.

Thus there are methods by which the collectivist State can exercise a control over the vagaries of money. But it cannot afford to *let monetary policy drift*. If it is to avoid the monetary troubles which have vexed the world in the past thirty years, it must be ready to put these methods into practice, and must apply them with vigilance and foresight.

Given those conditions, the collectivist State has some very substantial advantages in the management of money. It regulates both wages and prices. I have assumed that when the relation between the wage level and the price level has to be altered, it will be the price

level that will change. The wage level, even if the collectivist State has the power to change it, is the fundamental measure of the value of money. So long as the wage level is stable the value of the monetary unit is stable; a rise of prices relative to incomes is the natural consequence of a deficiency of supply, as a fall is of an excess of supply.

4. A wise management of the flow of money ought to prevent general unemployment. But it equally ought to do so under competitivism, and it has not. It has not because it has never been tried. Central banks and monetary authorities, while taking measures to regulate the flow of money, have disavowed the responsibility for influencing economic activity and employment. Alike under competitivism and under collectivism it is essential that that responsibility be admitted and accepted.

Even if general unemployment is avoided, there remains the special unemployment due to discontinuities in demand or in the conditions of production. Special unemployment is by no means peculiar to a competitivist economy. Change will inevitably be making workpeople in one occupation or another superfluous. But, so long as the vagaries of money are kept in control, unemployment of that kind can be dealt with on common-sense lines. A useful occupation in a new direction has to be found for each displaced workman, and he has to be fitted for it. In the interval before a change of occupation has been decided on the collectivist State can deal more satisfactorily with the redundant workman than the competitivist employer, for he can remain in the employment of the industrial undertaking in which he has been working and can continue to receive wages (whether full or reduced) from it, and to be subject to its discipline and directions. As soon as there is a prospect of his being employed in some other occupation he can be transferred to the new employment, and, if a period of training is required, will enter upon it under the appropriate conditions of wages and discipline.

The difference between wages and unemployment pay is something more than one of name. A workman who remains 'on the strength' of the industry to which he belongs, and receives directions accordingly, does not feel himself neglected by the community in his capacity as workman like one who is turned loose.

A workman should undoubtedly be allowed to cut himself loose from his employment and seek occupation in a new industry or a new place. If his new employment is still in a State-owned industry, he will of course depend on official references, and there is here a serious danger of unfairness and even of tyranny or persecution. The survival of a certain amount of private enterprise and private employment would supply a very desirable outlet for people who have encountered friction in State employment. But if there were much friction, there might come into being a class of malcontents too numerous for the per-

mitted private enterprise to absorb into employment. That is a special problem which might never arise at all.

It is conceivable that future economic development may eventually be such that the kind of work required is limited to certain functions all demanding special skill or faculties, and that there may be a class of people destitute of these aptitudes, who are incapable of any economic activity which will earn their keep, or perhaps indeed of any which will earn anything at all. Something like that happened in the free population of ancient Rome; when unskilled work was regarded as only suitable for slaves, the free man who had no skill commanding a market value became part of a proletariat enjoying the 'bread and circuses' publicly supplied. That the mechanisation of industry might similarly provide for all unskilled tasks, and give rise to a class of permanently unemployables, is rather a far-fetched supposition, and one moreover taking a very pessimistic view of the possibilities of human nature. The lesson of experience is that very ordinary people, when given opportunities, show surprising resources of imagination, discernment and character. There is often a latent creative power which under the deadening conditions of factory work and urban life is atrophied for want of outlet.

The problem of finding employment for those who are displaced by the mechanisation of industry has been with us for more than a century. Its extent has often been exaggerated, because it has made itself felt at times of general unemployment, when new or alternative employment has been difficult to find. At times of full employment, when the demand for labour in the active industries has readily absorbed those displaced, the problem of technological unemployment has been forgotten. But the problem exists, whether competitivism or collectivism prevails. The problem is in one aspect that of the embarrassment of plenty. The solution is to be sought partly in increased leisure, shorter working hours, a later entry into work, an earlier retirement, partly in a development of the kind of production to which mechanisation is not applicable, 'individuality products,' demanding a special craftsmanship or reflecting the creative faculties of the individual workman. There is a wide field of applied art, which does not demand the rare endowments of original genius, but which yet offers scope for a love of beautiful things. Production of that kind blesseth him that gives and him that takes. Creation and appreciation go together, and those who devote their lives to such work acquire and spread the tastes that make a demand for it.

CHAPTER XXII

INTERNATIONAL RELATIONS UNDER COLLECTIVISM

1. THE Communist movement, ever since the Manifesto made its appeal, Workers of the World, Unite, has had a cosmopolitan character. Its aspirations are in the solidarity of a working class which will know no national boundaries, and the common interests of which will be the basis of a loyalty and a discipline transcending all others.

That ideal claims to offer a way out of the international anarchy. But the claim has no real substance. The common interest of the workers may rally them in a class war, but, once the class war is over, it will have no power to prevent national cleavages and territorial jealousies from reasserting themselves. Even if the class war ended in a federation of the whole world under a single sovereign authority, that would be no safeguard against fissiparous tendencies. The problem of collective security and of constituting a world police force would not be materially changed unless the world State assumed a degree of governmental centralisation which seems quite beyond the limits of what is practicable.

The idea that the suppression of private profit-making would eliminate the economic causes of war is fallacious. Under competitivism the resources which constitute the sinews of war are gathered in the form of profits. Profit-making enterprise is relied on to organise production, and profits are the principal source of revenue and loans. But under collectivism the same resources would come into the hands of the State itself. They would more obviously and directly supply the basis of national power.

A system of national or territorial units, each capable of organising its own forces, whether ostensibly constituted as a federation, or admittedly a set of independent sovereign States, is an international anarchy, be they collectivist or competitivist.

But in any case, even if communism is destined to spread, it is unlikely to become universal and world-wide for a very long time. The practical question to be faced is the existence in the future of competitivist and collectivist States side by side.

It has sometimes been maintained that collectivism is only practicable either for the whole world, or for a closed group of countries cut off from trade or economic relations with the rest of the world. For if economic relations with countries in the rest of the world remaining under the competitivist system are allowed to continue, how are people to be prevented, not only from accumulating funds abroad, but from engaging in profit-making enterprise in foreign countries? In a collectivist community the existence of a few rich profit-makers

deriving their incomes from abroad, in contrast with the modest resources of their neighbours, would surely be intolerable. Perhaps there would be a prohibition of any such business, enforced by all the rigours of the criminal law. And exchange control would prevent payments for the acquisition of assets abroad and payments to foreigners or people resident abroad except for permitted purposes. As the operations of foreign trade, along with all other wholesale business, would be in the hands of the State, the permitted purposes would presumably be on a small scale.

But if travel is to be permitted and, as it should be, facilitated and actively encouraged, foreign intercourse is likely in some cases to offer the opportunity of a profit-making career. It may be only possible to take advantage of the opportunity at the cost of expatriation, but there will be people who will eagerly seek a fortune at that price. Some will return home disappointed, but others whose hopes are realised, even if they become domiciled and naturalised in a foreign country in order to retain their gains, are likely to maintain family and other ties with the country of their origin.

Intermarriage will also give rise to family ties with people in countries where profit-making still prevails. And, apart from any relations of kinship or business, there will be social contact with wealthy people from those countries.

Can unrestricted travel be permitted in face of these disturbing incongruities? What will be the effect on people subject to narrow restrictions of income and wealth, of intercourse with relatives, friends and acquaintances deriving big incomes and fortunes from profit-making abroad? The answer must be that, if collectivism cannot stand the strain of this intercourse, it is no solution of the economic problems which confront humanity. Social isolation such as has been imposed on inhabitants of Soviet Russia is odious. If collectivism has something of value to offer mankind, if it is to be anything better than an outlet for the have-nots' jealousy of the haves, it can afford to let those of its own people who so choose go in search of profit-making careers abroad. If it fails to make economic conditions at home attractive enough to the great majority for them to resist the glamour of money-making, it will never attain a secure foundation.

Is it humiliating for those who are eminent in society, in public affairs, in the professions or in business in the collectivist community to mix and to exchange hospitality with men of no greater position, who receive ten times or a hundred times their incomes? The wealthy profit-makers possess a kind of power to which the leading men of the collectivist community do not pretend. The power is that of buying their fellows' services, and, if those who work for the collectivist State have to confess that their power of buying their neighbours' services is confined to narrow limits, they can nevertheless boast that their

own services are not for sale. If collectivism makes a success of its task, and their country offers amenities to strangers as well as to themselves, they can hold their heads up, and need not be ashamed of offering a less lavish hospitality or being unable to participate in courses which make heavy demands on the individual purse.

There is a danger that, if all who choose are free to migrate in search of profit-making opportunities, there will be a persistent loss of those who have the special aptitudes and knowledge which make for success in trade. The collectivist State assumes the functions of the merchant in all branches of trade, and must have the services of experts in selling, who understand the grading of the commodities to be dealt in, the appropriate uses of all the different qualities, their advantages and defects for various purposes, and know what type or grade and from what source is likely to suit a possible purchaser. Anyone who has this expert knowledge in regard to commodities with a world market is well equipped for profit-making, and if he finds his income limited by the collectivist State which employs him to a mere fraction of what he knows he could make elsewhere, he is under a more direct temptation to cut loose than an adventurer looking for chances. This again is a difficulty that the collectivist State must face and possibly put up with. The aptitudes of the commercial expert can be acquired. If there is a wastage among those trained to the work, others can be trained to take their place. In a competitivist trading community the experience of the expert is not too easily acquired. To have it, a man must either embark his own capital in commercial enterprise or must obtain employment under a trader who has done so. A collectivist State can evolve a corps of experts, with an organisation planned to give systematic training. The more trained experts there are in the world, the less lucrative are the opportunities for any of them likely to be.

2. Apart from certain special cases, such as that of the publishers, the collectivist State cannot tolerate any private profit-making enterprise in wholesale dealing in commodities. It will therefore exercise a monopoly in foreign trade. In a foreign competitivist country the collectivist State will engage in buying and selling on much the same footing as an ordinary merchant, as the Soviet agencies have done in recent years. But it will be able to take a wider view than the ordinary merchant, having more systematic information as to the need of exporting industries to find markets for their output, and as to the state of demand for imports. It is not tied down to any limits of price or profit, and can sell at a loss or at a high profit with a view to securing favourable terms of trade on the whole, to avoiding undesirable discontinuities in its own economic activities, and to maintaining the standard of living.

To some extent these advantages will be obtained at the expense of

the other countries with which trade is carried on. When an exported product is sold cheap to avoid a reduction of output, the effect may be to impose the reduction of output on a foreign competitor. When an industry competing with imported products is concerned, and imports are restricted to maintain output, it is again the foreign producer who suffers. When demand for an exported product expands, the collectivist State may be able for a time to exact a high price at the expense of the foreign consumer.

It is not merely that the collectivist State has the advantages of a monopoly of its own foreign trade, but that it can make price concessions in case of need which a private monopolist could not face.

The existence of some collectivist States in the world would therefore be a disturbing factor in international trade, a disturbing factor of which the exchange controls and clearing agreements of the past ten years have given us a foretaste. In the absence of agreements to the contrary, the collectivist countries would be constantly inflicting discontinuities not only on those remaining competitivist but on one another. And it is not very easy to see any kind of formal agreement that would prevent them.

The problem is really one arising out of the international anarchy. So long as peace is potential war, every foreign country is a potential enemy (some being temporarily excluded from that character by an actual or prospective military alliance). An economic injury inflicted on a potential enemy becomes a subject rather of gratification than of regret.

International trade has long played a great part in the international anarchy, both as a source of economic power and as a means of inflicting loss on potential enemies. If that is to be changed, the international anarchy itself must somehow be overcome.

Even given goodwill, that cannot be achieved all at once, and meanwhile some method of keeping the vagaries of international trade in check will be urgently needed. The problem to be solved is one which in the case of particular industries has been dealt with by the device of international cartels. Where an industry is in the hands of a limited number of large concerns, they divide up the markets of the world among themselves, on a geographical or a quantitative or any other basis, so that there will be no competition of selling power among them. Since demand depends upon price, the cartel must also fix the prices of its products by agreement. It is a frank exercise of monopoly powers, and as such is open to abuse. But the purpose has normally been not so much to extort a high price from the consumer as to avoid discontinuities in production.

The principal export industries of a group of collectivist States might arrange cartels, the constituent industries of a cartel acting as a unit in their relations with competing industries outside the cartel.

They would allocate among themselves the markets both in their own countries and in the competitivist countries outside. The surplus remaining after the needs of their own people were satisfied would be offered in the competitivist markets at such prices as would ensure its absorption.

In case of a shrinkage of demand, the effect would be to throw the responsibility for reducing output on to the producers outside the cartel. The competitivist countries would endeavour to protect themselves, either through their own producers joining the cartel, or through tariff measures or import restrictions. There may be difficulties in the way of the producers in a competitivist country joining a cartel, especially if the industry is one in which there are numerous producers on a small or moderate scale. And import duties do not lend themselves readily to short period changes. The remedy is therefore likely to be looked for in licensing and quantitative restriction of imports.

Consequently it is probable that the adoption of collectivism by some countries would tend to perpetuate the deplorable practice of quantitative restriction of imports in the rest.

But once the Governments of the competitivist countries have decided to intervene in this manner in international trade, they will want to go further. They will want to make agreements regulating their dealings with the collectivist countries. If such agreements are to suit all parties, they should aim at a fair apportionment among them of the variations in output called for by the state of demand. There may be great difficulty in formulating an agreement which will have that effect. The state of demand at any moment is not definitely ascertainable. Sales have to be averaged over a considerable period in order to afford guidance. In a collectivist country those in charge of an industry will decide its output from time to time by reference to recorded sales and to estimates of future sales, resorting if need be to changes of price in order to avoid undesirable fluctuations of output. In a competitivist country the records and estimates of sales are not centralised. Retail dealers and wholesale dealers have cognisance only of partial data, and make their own separate estimates. The output of the producers depends on the orders received from the dealers they are accustomed to supply. These orders cannot well be made the subject of an agreement. Not only would it be difficult to collect particulars of them and arrive at an aggregate, but the aggregate itself requires interpretation. Its significance depends on traders' expectations and on their views regarding the regulation of their stocks.

3. It is probable that the practical solution resorted to will be that of clearing or barter agreements. But these need not repeat all the objectionable features of the agreements of recent years. In the first place it is to be hoped that the acute monetary troubles, which made the clearing agreements primarily a defence of weak currencies against

strong, can be avoided. Agreements which are worked in a spirit not of antagonism but of give and take would be very different. It should be an accepted principle of international commercial morality that all countries should avoid inflicting discontinuities on one another's economic activities. Changes, whether gradual or abrupt, should be introduced in such a manner as to minimise the resulting dislocation and loss.

Bilateral clearing agreements have had the fault of impeding triangular trade, the settlement of an excess of imports from one country with the proceeds of an excess of exports to another. But that has been the result of a general unwillingness to accept payment in a weak currency. Multilateral clearing agreements, providing for the crediting of each participating country with the proceeds of its exports to all the others in a common fund, upon which it could draw to pay for its imports from them, would meet the difficulty. If the disparity of weak and strong currency units still persisted, the countries with weak currencies would tend to adhere together, and the adoption of multilateral agreements would make their relations all the closer and their discrimination against the strong currencies all the more effective. But if a country with a weak currency adopts rates of exchange corresponding to equilibrium in its current balance of payments, its currency ceases to be weak; it can hold its head up in association with the strong currencies. If the country is too small or too poor to pursue an entirely independent monetary policy, it can hitch its currency unit to some international commercial and financial centre with which it has close economic relations.

Provided the currency units in the principal centres are kept stable in wealth value, no sweeping measures of inflation or deflation will be inflicted on the minor currency units linked to them. The foreign exchange markets of the world can be left to function as a piece of banking machinery, the foreign exchange reserves or gold reserves of the central banks or other monetary authorities being used to keep rates of exchange close to prescribed parities, but the actual provision of money in the places where it is needed being undertaken by the commercial banks. A collectivist State can find its place in the system, its single monopolist bank doing the business which under competitivism devolves on the commercial banks.

The competitivist countries need not exercise exchange control under such conditions. The collectivist State may have to do so in order to prevent its people from acquiring foreign assets in contravention of its principles. Exchange control would be concerned with capital movements. Current transactions would be in any case in the hands of the State.

The collectivist State would find itself with debit or credit balances accruing in the countries with which it dealt. So long as there is an

international foreign exchange market, it can sell the credit balances in some centres for the means of meeting the debit balances in others. It is free to buy and to sell whatever quantities of goods it may choose. No clearing agreement is necessary to enable it to equalise imports and exports with another country, or to maintain any desired excess of one over the other.

If the collectivist countries keep imports and exports equal or maintain unvarying differences between them, the discontinuities they inflict on one another and on competitivist countries will be kept within limits. Nevertheless they may still be quite serious. A country which finds its accustomed imports of a commodity suddenly cut down does not gain compensation for the loss in an equal reduction of some of its exports. It would prefer the country from which the imported commodity is derived to continue receiving the usual exports and to become indebted for a portion of the value.

Collectivism does not preclude international indebtedness. The collectivist State cannot avoid being to some extent either a debtor or a creditor, because the debits and credits accruing every day from its commercial transactions cannot be exactly balanced and cleared. These debits and credits might be covered by cash balances maintained in the countries with which it does business. If the cash balances are to be sufficient to meet substantial fluctuations, such as result from the variations of crops, they must be of the magnitude appropriate to a reserve. If gold remains in use as the medium for settling international payments, the reserve can be held in gold. Otherwise it must be a reserve of foreign exchange, constituting the country a creditor of those in which the reserve is held. If all countries held reserves in one another, any one of them would be the debtor as well as the creditor of any other, and that which was on balance a debtor would not in effect hold any reserve except to the extent that the other would permit the debit balance to increase. In these respects there is no substantial difference between collectivist and competitivist countries, except that the character of any foreign exchange transaction with a collectivist country is in some ways modified by the Government being the authority behind it.

4. But beyond reserves and cash balances is the question of the attitude of the collectivist State towards international investment. Even if private investment abroad is prohibited and prevented, it is still open to the State itself to engage in enterprise abroad, or to invest money in foreign loans. There is nothing in the principles of collectivism to preclude such operations. Profit-making is legitimate so long as the profit goes to the State.

At the same time profit-making by one country at the expense of another is an exploitation unpleasantly parallel to the competitivist trader's exploitation of his neighbours within the limits of his own

country. Another collectivist country would presumably refuse to allow it, or would only allow it if some very desirable enterprise could be started on no other terms. A competitivist country, however, is open to exploitation, and, if a collectivist country takes advantage of the opportunity so offered, its action may be defended as a case of spoiling the Egyptians.

The collectivist country exercises monopolistic powers over any of its products which on account of materials or craftsmanship peculiar to itself have qualities not supplied by producers elsewhere. The specialities of a competitivist country, on the other hand, are in general in the hands of competing traders and cannot be monopolised unless the traders agree to work together. Only in special cases can such an agreement be reached.

The collectivist country therefore has special responsibilities. And here, as in its trade agreements, mutual consideration is needed. If a collectivist country abuses its monopoly powers, other countries will retaliate. An import duty on a product received from a monopoly source will fall mainly on the monopolist, and competitivist countries can take a hand in exploiting their own monopoly products by arranging cartels or controlling exports.

A state of chronic conflict would be disastrous. What is desirable is a general agreement not to abuse monopoly powers and not to make changes which will inflict discontinuities on the economic activities of other countries. A formal agreement to that effect which would not be so general as to be full of loopholes could hardly be devised. But an agreement in wide terms, if supported by mutual goodwill and understanding, would gain recognition for the principles, and it would not on the whole be to the interest of any country to infringe them. The composing commission suggested in Chapter XIV might be the organ of such an agreement.

Given a general practice of mutual consideration among countries in their economic dealings with one another, external investment could revive. Collectivist countries could practise it alongside competitivist countries. They would have to give up the idea that, as collectivism means the extirpation of private ownership of capital, all capital not owned by the State, including that which is foreign-owned, must be confiscated. There is no reason why a collectivist State should not keep faith and observe its engagements. Foreign capital and foreign enterprise must be subject to its laws, but still can be treated fairly.

There may be presumed to be a need for external investment, that is to say, desirable capital outlay may exceed current accumulation in one country and fall short of it in another. One collectivist country may invest its surplus accumulations in another. The terms will be a matter of bargaining. They would not exclude interest or even profit at a moderate rate. The creditor country, unless it is experiencing a

positive glut of capital, is forgoing something by placing its resources abroad instead of at home. And if it has the choice between several countries for the field of its investment, and selects that in which the investment will be most fruitful, it is not reasonable that the whole of the advantage should go to the selected country and none to that making the investment.

If all collectivist countries were federated into a single State, the State itself would allocate capital resources. Capital outlay would be incurred on the installation of equipment at places selected for industrial extensions, and the selection would be guided by such considerations as the communications with sources of materials and centres of distribution, the existence or prospect of a surplus of employable workpeople, and the provision of housing and all the amenities required by a growing community.

The principle of mutual consideration pushed to its logical conclusion would lead a group of independent collectivist States to distribute new enterprise in substantially the same manner. Pushed to its logical conclusion indeed, it would end the international anarchy altogether. Mutual consideration in economic matters covers far the greater part of the field of international government. In that spirit it ought not to be difficult for a reconstituted League of Nations, acting through a composing commission, to succeed.

5. The collectivist State combines the responsibilities of accumulation and capital outlay with those of the sole land-owner. But its decisions as to the use of land cannot be made entirely without regard to private interests. There will be no private enterprise in the letting of house property, but if people are allowed to build or acquire houses for their own occupation, they must be given a certain security of tenure. Even if such transactions are not allowed and house accommodation has to be rented from the State, for many householders a mere tenancy at will would be quite intolerable. The arrangement, furnishing and decoration of a house are undertaken with a view to the occupier's continued enjoyment. One whose vocation makes him liable to frequent movement may be content to take furnished houses equipped and arranged by others, but those who have a reasonable prospect of remaining settled in one place will want to be secure against arbitrary eviction. In fact householders will want something very like the leasehold system familiar under competitivist conditions. The collectivist State will be the sole ground landlord and the sole builder, but it may consent to make the same kind of agreements with tenants as competitivist landlords and builders. Nor need it be unwilling to do so, provided it does not open the door to any undesirable form of private enterprise, whether in profit-making or in unearned increment.

CHAPTER XXIII

CONCLUSION

1. If the subject matter of economic science is work, it extends to all human actions except those which are self-sufficient, self-sufficient, that is, in the sense that end and means alike concern only one individual. Co-operative or joint action requires an extraneous motive. Not that it is necessarily done in ignorance of the true end or in indifference to it, but the aim at a common end, possibly remote and not easily understood, cannot be relied on to maintain organised and unremitting activity.

The economist is concerned with both the ends and the means. The ends, however, are given him from outside; they are a particular application of ethics. What differentiates economic systems from one another is the character of the motives they invoke to induce people to work.

Collectivism would substitute authority for gain as the motive. But would not the ideal perhaps be a kind of voluntary service relying neither on authority nor on gain? Under stress of war even a competitivist community has to subject a great part of its economic activity to regimentation. But regimentation is effective because those to whom it is applied are alive to the essential need of concentrating effort on the single aim of organised force. The motive is not blind submission to authority but active co-operation, in which State regulation is accepted as a necessary guidance, and a coercive procedure is only exceptionally necessary.

Would it be possible in time of peace to achieve a like singleness of aim? Unfortunately there is no true parallel. The singleness of aim in time of war is the response to an immense calamity, the need to face loss and injury in order to avert what is held to be a still greater evil, subjection to a hostile power. The loss and injury are common to all and understood by all.

War has a bracing effect because it is so gigantic an evil, and because the efforts it demands are essentially co-operative. The maintenance of organised force requires the members of the community to work together.

Work for welfare is also co-operative. But in welfare there can be no singleness of aim. The multiplicity of welfare is fundamental. Not only is its diversity infinite, but each individual has to find the opportunities for it for himself. The community can give him liberty, leisure, a free choice in the disposal of his resources, and facilities for intercourse, but cannot prescribe their use. Still less can it formulate a single end which is to be welfare, and to which all these opportunities are to be devoted.

2. Some would contend that the great religions of the world have done that and may still do it. Christianity gave mankind a new moral impulsion with the doctrines of sin and salvation. Salvation was not confined to a future life, but was interpreted by saints also to mean living this life on a higher plane.

No one anticipates all men becoming saints. Even if they did, work would have to be done. If the ideal realised were an ascetic life of contemplation, work might take a very subordinate place. That may be the self-chosen excellence of a few devoted souls, but it is hardly what those who hope for a religious solution of the world's troubles would prescribe for all humanity.

In the middle ages culture was in the exclusive care of the Church. Art and learning were dedicated to the glory of God, and were religious in theme and form. At first the other orders of society, the lords who controlled organised force and government, the merchants who carried on trade and formed cities, and the peasants and serfs who worked on the land, had hardly any share in culture. Material progress broke down the barriers, and when the fall of the Byzantine Empire released to the West the surviving traces of ancient civilisation, the Renaissance blossomed forth, and art, literature and learning were emancipated from their ecclesiastical bonds.

Something which had been lost with paganism was recovered. Paganism did not mean merely a superstitious worship of images and material objects and a belief in a crowd of immortals of doubtful morals. More fundamental than the naïvetés of idolatry and mythology was the propensity to hold sacred whatever in life was recognised to be important, whether good or bad, beneficent or dangerous, and yet was not fully understood. The knowledge of these things was preserved in ritual in the days when treatises were unknown.

Paganism consecrated the beauties and forces of nature, the passions and appetites of man, the excellences of poetry and art, the sun, the seasons, the crops and the rain. What was consecrated could not be adequately denoted by a representation or a bare name; it was not an abstraction but an object of emotion, which had to be personified to be expressed. Mythology elaborated the personifications with a legendary world of gods and goddesses, nymphs, satyrs and nereids, furies and fates, graces and muses.

When Christianity rejected the pagan cults and their mythology, the things of beauty in art, nature and poetry ceased to be worshipped as sacred. A new set of sacred subjects took their place, till the Renaissance enlarged the limits again. The separation of art and learning from religion was an innovation. The ethical domain of religion, apart from the realm of mystical ideals, became confined to the moral code. Things of beauty were no longer sacred (though none the less divine).

Implicit in the moral code there is, it is true, the welfare men owe

to one another. But it is only implicit, and the multifariousness of ends remains. The singleness of purpose which dominated medieval Europe was irremediably narrow.

Christianity is not tied down to the narrowness of the middle ages. It claims to give a living guidance in all the conduct of life, and therefore in economic relations. The rule of kindness Christianity shares with other religions and ethical systems. Yet Christianity gave it a new and passionate significance, redeemed from compromise with estrangement and retaliation, bidding man render good for evil and do good to those who do him harm or wish him ill.

From the rule of kindness made universal, it is a short step to equalitarianism and the suppression of class distinctions, and at times Christianity has been associated with those causes. In the eyes of the Christian every man has an immortal soul to be saved, and the inequalities of this world will be redressed in the next. But the inference has not invariably been drawn that the inequalities ought to be swept away in this world too.

Christianity enjoins indifference to material possessions. If wealth is a false end, there is room for a moral corrective to counteract the overestimation of it. Christianity, however, does not press indifference to wealth to the extremity of complete renunciation. The Gospels do not support such an interpretation. The young man with great possessions, who was told to sell all and give to the poor, had failed to notice the omission of 'Thou shalt not covet' from the recital of the Commandments. To take the command to sell all as of literal and universal application would be as unwarrantable as to take literally the injunction, 'If thine eye offend thee, pluck it out.'

Those who look to religion for a solution of the world's troubles denounce the materialism of the present generation. But what is meant by materialism? If the elimination of want and squalor and anxiety from the lives of the many is materialism, then the Christian is no less materialist than the communist.

Is economic action to go so far and no farther? Christianity teaches contempt for the good things of this world. But the golden rule, Thou shalt love thy neighbour as thyself, or Do as you would be done by, makes the individual the judge of the kind of benefit to be conferred on others. If he renounces luxuries and creative products for himself, is he also to renounce them for his neighbours? If all renounce the good things of this world for themselves in order to preserve them for one another, they are at cross-purposes.

Materialism in its evil sense means the pursuit of the false ends money, wealth and power. Its antithesis is not the righteousness which conforms to a code of moral rules, but the pursuit of right ends. Right ends do not exclude experiences to which work or material aids contribute, though they extend far beyond these. They are to be

discerned by appreciation, sensitiveness and emotional response, not by conscience.

Work makes wealth. But to say that work can contribute to a good life is a very different thing from reinstating the love of wealth. Wealth, the false end, imposes the wrong standard of measurement. And avarice consists not merely in applying this wrong standard, but also in asserting selfishly the exclusiveness of possession. Wealth is to be esteemed as no more than an auxiliary of well-being. Creative products are not to be assessed as mere products. Those at any rate which rise above the commercial level are themselves a part of human intercourse, and are not to be labelled materialism.

There are two applications of ethics to economic conduct for which the authority of Christianity is often claimed, the principle of a just price and the condemnation of usury. But there is nothing distinctively Christian about either.

No one would approve of an unjust price, but the meaning of justice in relation to price depends on the economic system in which price arises. If under competitivism a just price is one which neither takes advantage of the urgent needs of a buyer, nor deprives the producer or the seller of a remuneration sufficient to secure him a reasonable competence, a just price is no safeguard against the abuses of profit-making. The same price which secures a reasonable competence to the small trader confers much more than a reasonable competence on the trader on a large scale.

Usury, for which the term interest is a euphemism, was condemned by Christian and pre-Christian moralists primarily as an extortion from the needy. In modern economic conditions interest has become a by-product of profit. As we saw in Chapter XVII, it is futile to attack interest and to leave profit untouched. Among the exceptions allowed by the medieval Church to the general prohibition of usury was the case of the lender who by parting with his money lost an opportunity of making a profit (*lucrum cessans*).

The suppression of profit, as advocated by communism, cannot be said to be contrary to the spirit of Christianity, but it is not possible to claim the positive support of Christianity for it.

Christianity is invoked as a religion of peace. In the relations between individuals its most characteristic moral principle is that which forbids resentment or retaliation and enjoins gentleness and non-resistance. There are Christians who extend the principle to communities, and would set up an absolute prohibition against participation in war. But the great majority accept the duty of the citizen to serve in war. Even the limitation to service in a just war is not very generally insisted on. The justice of a war is always a matter of controversy and usually of doubt. And any war, however unjust in its origin, threatens national security once it has been engaged in.

The Christian statesman ought to avoid war. But how far ought he to go in exposing the people he is responsible for to spoliation or subjection in order to avoid it? Christianity cannot be said to give especially clear guidance in these matters. The moral principles and ideals upon which guidance depends are not the exclusive possession of any one cult or faith.

If public affairs came to be universally inspired by a Christian spirit, would all our troubles be at an end and our problems solved? A scrupulous regard for moral principles would certainly do much. But a blameless life is no substitute for practical wisdom.

The Christian's duty not to prefer his own welfare or advantage to that of his neighbour is clear. But, applied to the statesman as an individual, that goes no further than to forbid him to use his power in his own personal interest, and is common ground to all moral systems.

The late Lord Stamp in his *Christian Ethic as an Economic Factor* deprecated the claim that Christianity could, if it were only more Christian, put the world's ills right. As an instance, he referred to the instability of the monetary unit as the greatest single evil of our time, and contended that the 'quantity principle' of money, which 'lies at the root of trade depressions, unemployment, wage disputes and industrial unrest,' is 'quite independent of warm or cold hearts, sympathy, pity, or Christian sentiment' (p. 36). 'Without the proper intellectual solutions, no ethical factors will in themselves suffice to avert these evils' (p. 37).

It might be added that solutions have to be not only intellectually sound, but also guided by a right judgment of ends, which would be incompatible with a sweeping renunciation of the good things of this world. The philosophy of utilitarianism adopted a woefully limited end in 'pleasure,' a somewhat broader one, but still incomplete, in 'happiness.' But, however inadequate their conception of the good, they had the merit of distinguishing rules of conduct and economic and social institutions, as means, from the ends to which they are directed.

The ends that constitute welfare are multifarious, yet, it may be said, the good is single. The attribute Good always has one and the same meaning, to whatever it attaches. But only philosophers think about the singleness of good. The desires and aspirations of the normal man (or of the philosopher in his normal moods) are directed to the particular experiences that are good. Their unity is an abstraction. The anticipation of such experiences may excite little feeling or desire unless they are either vividly imagined or the subject of powerful associations. And the human mind cannot react to many such at one time.

The attraction of mysticism lies in the enlargement of the scope of

emotion by an effort of thought to comprehend *all* good. But that can never be the inspiration of all human conduct; it can only be the resort of those exceptional minds which are inclined to it.

3. In war singleness of aim is attained through submission to the discretion of leaders whose policy is victory. In peace time the accomplishment of political and social changes likewise calls for a submission to leadership, but the policy is not so easily defined. It can be defined as 'welfare,' but the multiplicity of welfare generates a multiplicity of causes, of parties and of leaders. Where there is general agreement, measures become a matter of the technical application of the art of government, and are not impeded by political controversy. But often measures which are recognised to be beneficial, and even evidently needed, are delayed by mere indifference and inertia, just because the zest of political conflict is absent. It is here that the contrast between war time and peace time becomes glaring.

But if war evokes so much more initiative and active co-operation than peace, that is only because the vast evils feared in time of war far transcend the modest positive benefits hoped for from most peace-time measures. Initiative and active co-operation, however, are valuable, and we may reasonably seek for economic institutions which favour them.

Competitivism is constantly recommended precisely on that ground. It is contended that profit-making gives the greatest possible stimulus, even the only possible stimulus, to enterprise, and that the free play of markets brings about automatic adjustments which maintain co-operation.

A collectivist executive responsible to a democracy is in a position to provide leadership in economic affairs. But whatever its constitutional basis, it cannot claim the same unquestioning acceptance of its decisions in peace time that a Government, whether democratic or not, receives in war time. For whereas success in war is a matter of military and administrative competence, on the merits of which only experts can judge, and people in general must trust to the judgment of the individuals chosen to assume these responsibilities, welfare, on the other hand, is a matter on which everyone has his own opinion. Administration and the framing of legislation are still matters for experts, but there is infinite scope for lay opinion on the policy to be embodied in them.

The Russian Five Year Plan was, it is true, an example in peace time of a great national effort concentrated at heavy cost on a single comprehensive economic purpose. The purpose was the equipment of the country with the productive resources of a great industrial community. The same kind of privation was exacted from the people as in war time in order to spare the productive power to create this equipment. The driving force was primarily a devotion to com-

munism. A communist country was unwilling to remain dependent on competitivist neighbours to supply its needs for industrial products. And no small part of the aim was to equip the country with those industries (engineering, chemicals, etc.) on which military power so largely depends. The Five Year Plan in fact was not only the extension to the Soviet Union of the industrial revolution which had transformed the economic condition of Europe in the nineteenth century, but it was also a great rearmament programme.

An economic effort such as that is exceptional. Even if the world fails to escape in the future from the threat of total war and the overwhelming burden of armaments, the problem of making the best application of the residue of productive power to promote the welfare of the community will remain. In that deplorable contingency mankind would have to submit to a continuance of the age of scarcity, but the more exiguous the resources left over for welfare, the more imperative would it be to make the best use of them.

In such circumstances, whatever the political and economic institutions of a country may be, what is needed is not a spurt, such as may be elicited through a great wave of enthusiasm, but a sustained effort.

When unfavourable comparisons are drawn between the slackness and inertia of peace time and the concentrated energy of war time, the point of the contrast is usually not so much the want of drive and the tardiness of progress in peace time as the prevalence of unemployment. The flow of money is swollen in war time by a torrent of Government expenditure, and the Government hunts out all available hands to work for the one imperative purpose. But the inference that a torrent of Government expenditure is the only way to prevent general unemployment is fallacious. We have seen how the problem of stabilising the flow of money should be approached.

General unemployment apart, there is still claimed to be an evident advantage in the Government assuming the responsibility of economic leadership. Even if the errors which have brought the economic system of the world to something like a breakdown in the past quarter of a century can be avoided in the future, it does seem that let-do cannot hope to achieve a perfect co-ordination of effort. Does that mean that collectivism is necessary or desirable, independently of any condemnation of profit-making ?

It is certainly not decisive in the matter. There are in any case numerous and important departures from let-do which are recognised to be necessary, and in the field that is left clear for competitivism the play of markets goes a long way towards maintaining co-ordination. Nor can collectivism itself ensure co-ordination. The efficient working of collectivism is a gigantic administrative undertaking, and no one can say how far it can in practice be achieved. It demands a balance

between delegated powers, which may lead to abuses, and a centralised authority which may impede activity with a paralysing regimentation. We do not know enough of Russian experience to be able to say whether it is encouraging in this respect or the reverse. Even if the administrative problem is solved, there are still, as we have seen, numerous ways in which collectivism may have detrimental effects on liberty and enlightenment.

4. But even competitivism is by no means irreconcilable with a certain kind of economic leadership. Much has been heard in recent years of planning. Any public enterprise of course involves a plan, and a collectivist State must make plans for all its manifold activities. But the competitivist State can offer its help in exercising foresight and introducing system outside the limited sphere in which it assumes the responsibility for enterprise itself.

It can view the operations of any industry objectively from the standpoint of public policy and the general welfare, and make known the conclusions arrived at from time to time. Traders, even when intent on profit-making, will not be entirely indifferent to the other consequences of their operations, and may be quite ready to conform voluntarily to recommendations so long as their profit-making is not seriously interfered with. When action is called for which does conflict with the traders' self-interest, it can be enforced upon them without going the whole length of nationalising the industry. To that, no doubt, there are limits. Compulsion can be successfully exercised when the action enforced is for the visible advantage of some class of people, such as the traders' employees or customers, or when some clearly definable abuse is made an offence. But more intangible requirements cannot be imposed by regulation.

Planning may sometimes assist the traders' own self-interest, when, for instance, a Government offers facilities for the co-operation of those carrying on a trade or industry in marketing their product, in testing demand, or in technological research.

An application of planning which has gained attention in the present century is town planning. Town planning is based on compulsory powers, and may include the actual undertaking of works of development and building by the planning authority. But the compulsory powers can be limited to deciding what uses the portions of land dealt with are to be put to, and prescribing conditions to which buildings and works must conform, without interfering with private enterprise so long as those conditions are fulfilled. The powers can be used to direct urban and industrial development to the places judged most suitable for them on general grounds; they override the discretion both of land-owners and of intending traders or builders seeking sites, but do not necessarily restrict the enterprise of the latter very materially. Often traders will value the guidance given, for the more comprehensive

view that a public authority can take of requirements and facilities may enable them to save private enterprise from costly miscalculations.

Thus planning may do much to promote a more enlightened co-operation even of profit-making traders. Planning on the part of the Government, alike in a competitivist community or in a collectivist, is only beneficial if the Government itself is equipped with sufficient practical wisdom. If collectivism is to be anything but a disaster, that condition must be presupposed.

In some respects competitivism makes heavier demands on human wisdom than collectivism. For collectivism the problem is an administrative one ; all work is subject to authority, and the appropriate directions have to be formulated, handed down and enforced. For competitivism the problem is one of influencing appropriately the primarily free action of the multitude. Competitivism has to allow for the short-sightedness, the miscalculations, the prejudices, the unaccountable emotions of a crowd, as well as for the tortuous devices of self-seeking. The interference of the State has to work through this unruly material, and economic science is in large part a science of human nature.

Human nature is not so erratic as to defy systematic study altogether, and it would be an ignominious predicament for mankind if economic institutions had to be revolutionised merely because human wisdom could not cope with the abstruseness of competitivist economics. Competitivism can be made to work if the economic principles through which it works are understood. A repetition of the blunders of the interval between 1918 and 1939 would mean an inevitable breakdown.

A breakdown might lead either to a summary imposition of collectivism or to a totalitarian system which could only be provisional. Totalitarianism means dictatorship of a party, and cannot form a system unless the party is identified with a cause or a policy.

A precipitate and unconsidered change is likely to be disastrous. Even if the new institutions to be established have been well thought out, their establishment in haste is likely to be attended by grave dangers.

5. After the present war a trying period of reconstruction must in any case follow. It is important in the first instance that people everywhere get back to work as soon as possible, and to do so they must return to the ways and vocations which they know. The world must pick up again more or less where it left off. Even so there will be an immense residue of unallocated productive resources to be placed.

The world's industry was seriously out of trim in the years preceding the war. When hostilities cease and peace-time production is restored, there will be an intense demand for a wide variety of products. Up to a point this demand can be met by bringing back the workpeople to the industries in which they have been employed before, making good

defects and arrears of maintenance in the plant, providing materials and re-establishing selling and transport organisations. So long as each of these operations takes the form of restoring something previously in existence to working trim, the governing policy is straightforward, however difficult and complicated the details may be.

But there will be great changes in requirements. The reinstatement of the world's capital equipment after the destruction and the arrears of capital outlay and maintenance entailed by the war will call for an effort comparable to that of the Russian Five Year Plan. It may be that organisation from the centre little less complete than that imposed in war time may be found necessary. The diversion of productive power into the right channels can hardly be left to the unorganised operation of the profit motive. The individual trader will not be in a position to foresee the future state of demand. In quiet times he relies on continuity as the foundation of his estimates, and it is the deviations from the assumed trend that have to be interpreted. When consumption and production alike have been subjected to violent restraint and dislocation for several years, the forecasting of demand and the adjustment of supply have no fixed starting point.

The Government can assist traders very materially, especially in seeing that each industry, as a whole, has all available information bearing on current and normal demand, and current and prospective supply. In war time the Government controls production mainly through the regulation of labour and of the distribution of materials. The detailed control which restricts and directs the output of industries supplying the needs of civil life depends mainly on these two factors. On the return of peace, materials will probably still continue to be a limiting factor in some industries, and the Government will have to take the responsibility of allocating them. The revival of private enterprise and the redistribution of labour will be shaped for a time by the available materials, and, in some cases where materials are available, there will be a shortage of effective plant. These immediate shortages should be detected by the Government, and steps taken so far as possible to remedy them.

It may be that positive action will be required from the Government amounting to something not far short of full-blown collectivism. If so, the most effective way of exercising control, whether it be a temporary departure from competitivism or a transition to collectivism as a permanency, will be for the Government to take over the functions of the wholesale dealer, not only the wholesale dealer in the strict sense, who buys in order to sell, but the selling side of those producers who supply retailers direct. And where there is a big retailer who has assumed the wholesaler's functions and buys from numerous independent producers direct, the Government would have to intervene in his buying business.

This public control of wholesale dealing would place on the Government the responsibility of giving orders to producers, of regulating the stocks held at wholesale, and of quoting the prices charged to retailers and paid to producers. Prices charged by retailers and stocks held by them, if they were to be controlled, would have to be regulated independently, but the Government would have overwhelmingly effective sanctions in its hands to enforce its regulations.

To undertake the business of wholesale dealing, the Government must secure the services of those already experienced in it. War conditions, at any rate in Great Britain, have in any case given the Government a control both wide and deep and an intimate contact with the traders, and war taxation has reduced what they retain out of their profits to exiguous proportions.

If the control is not to be impossibly intricate and complicated, the wholesale traders who act under the authority of the Government must have considerable delegated powers. They must discharge their normal functions of knowing the qualities and grades of the products they deal in, the uses to which they can be most suitably put, and the best way to satisfy from them the requirements of all the different kinds of buyers in the market. For materials and intermediate products the buyers will be manufacturers; for finished products they will be consumers. It is the business of wholesale dealers to be acquainted with both, and not only to sift out a given supply in such a manner as best to meet the requirements, but so to direct their orders to producers and so to frame specifications as to procure the most suitable supply.

These things they must continue to do. But they must keep the Government informed of the output they are receiving of every product and of the orders they are giving for future output, and they must be prepared to make these orders conform to instructions given by the Government in the light of the state of labour and of plant, and the supply of materials.

And what use is the Government to make of its power? Obviously it must continue its war-time function of maintaining essential supplies and services. But it should also make every effort to accelerate the resumption of every useful activity by facilitating the movement of labour and materials into the enterprises which are in readiness to resume production and distribution, and by giving them immediate orders for their products. The production even of the merest superfluities and luxuries should not be held up, so long as there is an effective demand for the products, and the supply of labour and materials to make good scarcities of more important products or for other urgent purposes is not impeded.

Alongside the enterprises which are immediately ready to produce will be others which will require capital outlay or the training of labour

to prepare them. The Government can give the signal to them to take the necessary measures to enlarge their output by giving them orders calculated to keep an increased capacity occupied. It may also itself afford facilities for training workpeople, and may assist the necessary capital outlay.

The Government's control of wholesale dealing would not of itself extend to capital outlay. Wholesale dealing covers many commodities which are destined for use in capital equipment, but these would be sold to traders who need them for that purpose in the same way that consumable goods are sold to retailers. But the Government will undoubtedly have to exercise considerable control over capital outlay, and to undertake much such outlay on its own account. It is expected that extensive housing and town-planning operations will be undertaken by public authorities. Arrears of maintenance and new construction and the destruction inflicted by war will demand new building on such a scale that in many places sweeping new plans will be appropriate, and the whole will, no doubt, be made subject to a central control to ensure conformity to a national policy based on a comprehensive view of the most desirable local distribution of industry and population.

The local distribution of industry governs the local distribution of the people employed in it, and the local distribution of consumers governs the local distribution not only of retail business, but of many branches of production. The local distribution of a great part of industry is already determined ; the plant is already in existence along with the means of communication and the housing accommodation and amenities for the people directly or indirectly engaged in the industry. But the great discontinuity caused by war leaves an exceptionally large proportion of potential industry free to choose its situation, and that of a corresponding part of the population.

The new enterprise by which this potential industry becomes actual and exercises its choice, if promoted by traders, will be determined by their estimates of demand. Under normal conditions, when continuity in the growth of industry is preserved, the trader estimates future demand mainly by the orders he and his competitors are actually getting, but at the same time takes account of any circumstances modifying the relevance of present to future demand. But if the orders are given not by merchants and retailers but by a Government-controlled organisation, clearly the first step in interpreting present demand must be to consult that organisation. That of itself will give the Government great influence on capital extensions. But it will probably be necessary to apply a more direct control in order to keep capital outlay as a whole within the limits allowed by the resources of the instrumental industries and monetary policy. A judicious middle course has to be steered between excessive expansion of the instru-

mental industries and delay in accomplishing essential capital outlay. If free play were allowed to private enterprise, the deciding factor would be finance. Those who had or could raise sufficient funds could do the desired renewals, improvements and extensions. The money offered would undoubtedly greatly exceed the resources of the instrumental industries within the time limits contemplated for the work, and the prices exacted by these industries for completion within those limits might be forced up to a very high level. A powerful inducement would thus be given them for excessive expansion.

To control this dangerous situation, it will be desirable not only to employ drastic monetary expedients (such as a forced loan—see above, pp. 243–4), but to apply controls to capital outlay. The licensing of new capital works and of new issues in the investment market will not be enough, for a very great part of the capital outlay will be for arrears of maintenance and renewals financed from reserve funds. Control will have to be applied direct to the instrumental industries. Since it is above all the instrumental industries, especially engineering and construction, that are affected by war conditions and subjected to war controls, there will be no very great administrative obstacle to this course.

Control has its dangers. Competitivism has the fundamental advantage of decentralising decisions. The trader, like the feudal lord, has free discretion within the limits of his authority. When a decision has to be reached not by numerous independent individuals and concerns but by a centralised authority, the assembling of the data on which the decision has to be based becomes a great administrative problem. Conflicting claims have to be heard, experts who can judge the strength of claims have to be consulted, and ultimately the laymen in authority have to weigh the evidence of the experts and the cases put forward by the claimants.

An established collectivist State which has got into working trim in the course of a generation's experience may be expected to have reduced this process within manageable limits. But there is great danger that a Government new to it, and applying such methods to the urgent needs of the first transition from war to peace, might be struck with a paralysis which would involve the process of reconstruction in desperate delays. It is desirable at that stage to allow as much scope as is consistent with a policy of foresight to private enterprise.

Control of wholesale dealing and within limits of capital outlay would place the Government in a commanding strategic position in the economic system. It would have substantially as wide powers as a collectivist State. Yet profit-making could be allowed to continue. Producers would sell their output to the Government-controlled dealers, and retailers would buy their supplies from them, but both producers and retailers would continue to work for profit. The

wholesale dealers themselves would have to be remunerated on a basis taking account of potential profits. Prices would be regulated and profits would be taxed.

A thorough and comprehensive Government control would be maintained over the economic life of the community without prejudice to future policy. The initial dangers and difficulties of the transition to peace conditions once surmounted, future policy can be considered. It will be possible either to withdraw Government control step by step as industries regain normal capacity and normal demand, or to make it permanent, to suppress profit-making, and to transform the profit-making traders into salaried servants of the State. It would be impossible to effect this great transition at a stroke without acute political controversy, and difficult to do so without violence. It is not unlikely that people will shrink from the fateful step, and will yet be unwilling to give up the control which keeps the door open to it. There is thus a third possibility, a continuance of profit-making under Government control. Indeed if collectivism is to be the ultimate solution, there is much to be said for a relatively prolonged trial of the intermediate stage, in which the administrative staffs of the Government will learn the ways of trade and industry, and traders will learn to accommodate their operations to public policy. Perhaps after some years the country might lapse painlessly into collectivism without any serious controversy. If, on the other hand, the ultimate choice were to revert to competitivism, the experience would still be found to have been salutary, and the possibility of a re-establishment of control would remain as a restraint on the abuses of profit-making.

6. The horror and agony of war provoke from time to time an anxious questioning: what is it being fought for? And the questioner will supply his own answer; it is being fought for a better life, for an escape from the shameful ineptitudes which have inflicted such calamities on this generation.

Primarily, however, the war is being fought to avert an immense disaster, a tyrannical misuse of organised force. Only when the ominous succession of events had shown that no limit could be put to totalitarian aggression and that no considerations of international good faith would stand in its way was armed resistance to it resorted to. Aggression meant conquest, and conquest meant oppression, repression and spoliation such as the world had never experienced before. The Powers which resisted found themselves confronted with an organised force so vast as to threaten the whole world with subjection.

Successful resistance to this menace is what the war is being fought for, and successful resistance will reopen to mankind the *opportunity* for a better life. But the opportunity is all that victory can gain. Liberty itself, as we have seen, is not an ultimate end. It is a noble

and inspiring cause, but for all that it is no more than a means, an opportunity.

A victorious issue of the war will clear the ground once more for constructive efforts. If those efforts are wisely conceived, their results may legitimately be regarded as a part of the fruits of victory, and if they fail, that part will be wanting. But still the primary purpose will have been achieved.

It will have been achieved, but for how long? After all, what gave totalitarianism its chance was the economic breakdown, and another breakdown might have like catastrophic consequences. So long as economic institutions respond to human direction, and economic policy makes its due contribution to a good life, the mass of men will have no temptation to resort to disruptive violence. But if once again all is found to end in impotence and frustration, then discontent will be succeeded by impatience, and impatience by desperation.

In this way then we are fighting not only to preserve the opportunity for the good life, but to make a right use of the opportunity. And indeed making the right use is actually a condition of ultimate success in the struggle. For a default therein might itself revive the menace.

A change of spirit, it is contended, is what is really essential. But human nature cannot be changed to order. The evil tendencies of the present time are not due to a bad phase of human nature but to circumstances. The international anarchy is a sure source of war. Wage and labour troubles are the outcome of the abuse of profit-making. Monetary instability was the cause of the general unemployment which gave National Socialism its foothold. It was monetary instability too, not economic nationalism, that gave rise to the paralysing restrictions of international trade.

In the preceding pages I have endeavoured to dispel the economic defeatism that sees a perverse fate bringing all plans for a better life to naught, and accepts recurrent depressions as inherent in the nature of things. Depression has been caused in the past by deliberate action in the monetary sphere. In the years 1920–2 and 1929–32 measures were taken in England and America for the explicit purpose of diminishing the flow of money and counteracting inflationary tendencies by inflicting depression on the world. The measures taken were far more drastic, because longer sustained, than any resorted to in the nineteenth-century trade cycle, and the resulting contraction in the flow of money was correspondingly greater and the depression more severe.

The first condition of making competitivist institutions function is that monetary authorities should refrain from this disastrous action. It is practicable to maintain a sufficiently stable flow of money, and, if that is achieved, the worst troubles will be overcome. Not only can trade depressions and general unemployment be avoided, but the

dislocations of international trade and the foreign exchanges can be kept within manageable limits.

But other problems will still remain. Is profit-making to be tolerated? Supporters of competitivism maintain that it is indispensable as the motive of enterprise. Its abuses have been partially rectified by levying ransom upon it for social services. Ransom is a compromise. Is it raising direct taxation beyond the practicable limit and making the fiscal machine top-heavy? And even so does not ransom fail to effect any real reconciliation between profit-making and wage policy?

To these questions no one can give a decisive answer, but it is to be hoped that the issues will be brought out into the open, and that those who take part in making the choice will do so with an understanding of the consequences.

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